DENMARK

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE—BANKING REGULATION AND SUPERVISION

This Technical Note on Banking Regulation and Supervision for the Denmark FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in July 2020.

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DENMARK

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TECHNICAL NOTE

BANKING REGULATION AND SUPERVISION

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Denmark during October 2019. It contains technical analysis and detailed information underpinning the FSAP’s findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx
CONTENTS

Glossary ......................................................................................................................... 3

EXECUTIVE SUMMARY ................................................................................................. 5

INTRODUCTION ............................................................................................................... 9
A. Scope and Approach ................................................................................................. 9

DFSA: MANDATE, INDEPENDENCE AND RESOURCES .................................................... 10
A. Background ............................................................................................................... 10

BANKING REGULATION AND SUPERVISION ............................................................... 16
A. Market Structure ...................................................................................................... 16
B. Institutional Safety Net ............................................................................................ 18
C. Supervisory Approach ............................................................................................. 18
D. Supervision of Specific Risks .................................................................................. 26
E. Use of Supervisory Powers in a Changing Environment ........................................... 37

BOXES
1. Financial Technology and the DFSA ....................................................................... 13
2. Use of Covered Bonds by Danish Banks for Liquidity Risk .................................... 36

TABLE
1. Main Recommendations ............................................................................................ 7

APPENDICES
I. DFSA Powers of Corrective and Remedial Actions .................................................. 43
II. Summary of Quantitative Liquidity Requirements in Denmark ............................... 46
# Glossary

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>AML</td>
<td>Anti-money Laundering</td>
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<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
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<td>BCP</td>
<td>Basel Core Principles for effective banking supervision</td>
</tr>
<tr>
<td>BoD</td>
<td>Board of Directors</td>
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<td>BoM</td>
<td>Board of Management</td>
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<td>BRRD</td>
<td>Bank Recovery and Resolution Directive</td>
</tr>
<tr>
<td>CDD</td>
<td>Customer Due Diligence</td>
</tr>
<tr>
<td>CET1</td>
<td>Common Equity Tier 1</td>
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<td>CFRP</td>
<td>Contingency Funding and Recovery Plan</td>
</tr>
<tr>
<td>CFT</td>
<td>Countering the Financing of Terrorism</td>
</tr>
<tr>
<td>CRD</td>
<td>Capital Requirements Directive</td>
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<tr>
<td>CRR</td>
<td>Capital Requirements Regulation</td>
</tr>
<tr>
<td>DAR</td>
<td>Detailed Assessment Report</td>
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<tr>
<td>DFSA</td>
<td>Danish Financial Supervisory Authority</td>
</tr>
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<td>DGFSR</td>
<td>Directorate General for Financial Supervision and Regulation</td>
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<td>DN</td>
<td>Denmark National Bank</td>
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<tr>
<td>ECB</td>
<td>European Central Bank</td>
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<td>EU</td>
<td>European Union</td>
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<td>EBA</td>
<td>European Banking Authority</td>
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<td>EC</td>
<td>Essential Criterion</td>
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<td>ESCB</td>
<td>European System of Central Banks</td>
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<td>FATF</td>
<td>Financial Action Task Force</td>
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<td>FBA</td>
<td>Financial Business Act</td>
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<td>FSAP</td>
<td>Financial Sector Assessment Program</td>
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<td>FSC</td>
<td>Financial Stability Company</td>
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<tr>
<td>HQLA</td>
<td>High Quality Liquid Assets</td>
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<td>ICAAP</td>
<td>Internal Capital Adequacy Assessment Process</td>
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<td>ICCS</td>
<td>Inter-ministerial Committee for Credit and Savings</td>
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<td>ICT</td>
<td>Information and Communication Technology</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<tr>
<td>ILAAP</td>
<td>Internal Liquidity Adequacy Assessment Process</td>
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<td>ILKE</td>
<td>International Market Contact, Liquidity and Capital division</td>
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<tr>
<td>IPS</td>
<td>Institutional Protection Scheme</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>IRB</td>
<td>Internal Ratings Based</td>
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<td>IRRBB</td>
<td>Interest Rate Risk in the Banking Book</td>
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<td>ITS</td>
<td>Implementing Technical Standard</td>
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<tr>
<td>JSC</td>
<td>Joint Stock Company</td>
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<tr>
<td>LCR</td>
<td>Liquidity Coverage Ratio</td>
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<tr>
<td>MEAI</td>
<td>Ministry of Economic Affairs and the Interior</td>
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<tr>
<td>MER</td>
<td>Mutual Evaluation Report</td>
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<tr>
<td>MIBFA</td>
<td>Ministry of Industry, Business and Financial Affairs</td>
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<td>MLF</td>
<td>Money Laundering Forum</td>
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<td>MLS</td>
<td>Money Laundering Secretariat</td>
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<td>MoF</td>
<td>Ministry of Finance</td>
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<td>MoU</td>
<td>Memorandum of Understanding</td>
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<td>NCA</td>
<td>National Competent Authority</td>
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<tr>
<td>NPE</td>
<td>Non-performing Exposure</td>
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<td>NPL</td>
<td>Non-performing Loan</td>
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<td>NSFR</td>
<td>Net Stable Funding Ratio</td>
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<tr>
<td>P1</td>
<td>Pillar 1</td>
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<tr>
<td>P2G</td>
<td>Pillar 2 Guidance</td>
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<td>P2R</td>
<td>Pillar 2 Requirement</td>
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<td>PEP</td>
<td>Politically Exposed Person</td>
</tr>
<tr>
<td>OCR</td>
<td>Overall Capital Ratio</td>
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<tr>
<td>RCAP</td>
<td>Regulatory Consistency Assessment Program</td>
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<td>ROA</td>
<td>Return on Assets</td>
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<td>ROE</td>
<td>Return on Equity</td>
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<td>SEP</td>
<td>Supervisory Examination Programme</td>
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<td>SI</td>
<td>Significant Institution</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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<td>SRC</td>
<td>Systemic Risk Council</td>
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<tr>
<td>SREP</td>
<td>Supervisory Review and Evaluation Process</td>
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<tr>
<td>SSM</td>
<td>Single Supervisory Mechanism</td>
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<td>SSMR</td>
<td>Single Supervisory Mechanism Regulation</td>
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<tr>
<td>STR</td>
<td>Suspicious Transaction Report</td>
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<td>TN</td>
<td>Technical Note</td>
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</table>
EXECUTIVE SUMMARY

COVID-19 pandemic: The Financial Sector Assessment Program (FSAP) work was conducted prior to the COVID-19 pandemic, so this Technical Note (TN) does not assess the impact of the crisis or the recent crisis-related policy measures. Nonetheless, given the FSAP’s focus on vulnerabilities and policy frameworks, the findings and recommendations of the TN remain pertinent.

The Danish Financial Supervisory Authority (DFSA) has improved standards in its oversight of banking and insurance sectors since the last FSAP. Nevertheless, risks persist, both in traditional forms, and new areas, such as cyber risk, AML, and innovative market entrants. This note, selects topics to meet evolving supervisory challenges and the expectation that the international supervisory standards themselves will likewise continue to rise.

The operational independence of the DFSA remains an issue. The respects in which the DFSA’s operational independence is undermined fall into two broad categories: governance and resource. While practical constraints exist, improvements can be made in both areas. Resources continue to constrain the DFSA inappropriately. Despite welcome increments to AML and insurance staffing, risks to the financial system are outpacing staffing. The funding structure does not isolate the DFSA from the potential influence of either the government—a ministry representative sits on the Board with observer status—or of the industry. The DFSA must not be required to operate on a “least cost” basis as this undermines the quality and needed further development of policy and processes, as well as the scope and execution of its tasks, notwithstanding a cadre of dedicated staff. High turnover of junior staff and lack of depth at middle management are particular concerns, irrespective of the clear quality of the individuals.

The DFSA’s supervisory approach focuses strongly on traditional financial risks; in particular credit risk in banking and market risks and asset-liability management in insurance. The DFSA must complement its strong credit risk skills with equal rigor in other areas. Sharpening supervision of non-financial risks, including entities’ compliance, governance, conduct, compensation practices and risk culture, will be supported by forthcoming legislation in this area.

The DFSA should develop more detailed guidance on the risk assessment of individual supervised entities to support supervisory judgement and ensure consistent outcomes. Articulating and documenting guidance using examples and clear parameters will more effectively support supervisory assessments and consistent ratings. All relevant risks should be captured with appropriate and consistent weightings applied in the assessment process.

Corporate governance assessments in banks need to complement ‘bottom-up’ with ‘top-down,’ assessments. Examining corporate governance through the lens of a specific risk area has limitations and, as new legislation will be required in any case, it is essential to conduct ‘top-down’ analysis looking at the functioning and performance of both the Board of Directors (BoD), senior management and governance structures more broadly.

The number of certified auditors has been declining since the auditor certification regime was introduced in 2014. Unamended, the current certification requirements for bank and also insurance
external auditors may lead to a shortage of qualified professionals. The DFSA must ensure its certification regime is appropriately balanced to avoid this outcome.

**Risk experts at the DFSA should both proactively and reactively provide advice, analysis and support to supervisors.** Ensuring that risk experts horizontally analyze data will allow for the identification of risk trends and concentrations that supervisors may not be able to identify at an individual entity level. Risk decisions and advice should also be centrally recorded to ensure consistency and allow for additional analysis.

**The DFSA should prioritize and increasingly invest in its own IT/data systems to support supervision’s analytical capabilities.** The DFSA should leverage the data created as part of its own supervisory work to identify trends and emerging risks.

**Valuable initiatives are underway to enhance anti money-laundering (AML) supervision and the DFSA must take ownership of the outputs from the current projects.** Despite the AML priority, there is a clear risk that staff will be unable to meet the high political expectations due to resource limitations. Risk areas that provide early insights and warnings to AML risks, such as operational risk, IT risk and compliance, may also be squeezed for resources. In other words, while the DFSA is aware of the importance of these risks and numerous projects have been undertaken, not enough progress has been made so far.

**The DFSA benefits from a wide and graduated set of powers, which it uses, and some are being augmented through AML legislation.** The DFSA must act on its plans to analyze corrective action data to ensure it is identifying patterns and root causes of deficiencies. In terms of authorization, changes of control, and fit and proper assessments for individuals, the DFSA must communicate that its expectations are rising. The onus must be on applicants to demonstrate they fully meet the substance, not just the superficial terms of the requisite standards. New techniques may be needed to employ more rigorous tests in reaching decisions.
<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Responsible Authorities</th>
<th>Timing*</th>
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<tbody>
<tr>
<td><strong>Independence and Resources DFSA</strong></td>
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<tr>
<td>Base the Board appointment process on a Parliamentary process. Lengthen tenure</td>
<td>DFSA</td>
<td>Mid Term</td>
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<td>of Directors’ appointment and de-link from the political cycle. Remove the MIBFA</td>
<td>MIBFA</td>
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<td>representative from the Board.</td>
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<td>State the reasons for the dismissal of a Board Director and Director General</td>
<td>MIBFA</td>
<td>Mid Term</td>
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<td>clearly in law and publicly disclose in the event a dismissal should ever take</td>
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<td>place.</td>
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<tr>
<td>Expand budget envelop for DFSA to recruit and retain quality staff across full</td>
<td>MIBFA</td>
<td>Short term</td>
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<td>range of skills and experience and with a focus on non-financial risks.</td>
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<td>DFSA to publicly communicate its supervisory capability, based on its resource</td>
<td>DFSA</td>
<td>Short term</td>
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<td>envelope and published risk appetite statement.</td>
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<tr>
<td>Broaden use of external expertise in priority areas to supplement risk</td>
<td>DFSA</td>
<td>Short term</td>
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<tr>
<td>expertise.</td>
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<td><strong>Regulation and Supervision – Banking and Insurance</strong></td>
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<tr>
<td>Develop more detailed guidance on risk assessments (using examples and clear</td>
<td>DFSA</td>
<td>Under 6 months</td>
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<td>parameters) to support supervisory judgement and ensure consistent outcomes.</td>
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<tr>
<td>Formalize cooperation processes to enhance transparency; ensure a more</td>
<td>DFSA</td>
<td>Under 6 months</td>
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<td>consistent approach to engagement with firms; and mitigate risks associated</td>
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<td>with staff turnover and key person risk.</td>
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<tr>
<td>Prioritize and increasingly invest in IT/data systems to support analytical</td>
<td>DFSA</td>
<td>Short term</td>
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<tr>
<td>capability.</td>
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<tr>
<td>Increase horizontal analysis across risks, entities and industries to identify</td>
<td>DFSA</td>
<td>Short term</td>
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<tr>
<td>trends and emerging risks. Enhance data analysis on non-financial risks.</td>
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<tr>
<td>External auditor certification regime must balance standards and availability</td>
<td>DFSA</td>
<td>Mid term</td>
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<td>of professionals for banks and insurers.</td>
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<tr>
<td>Exploit database of corrective and remedial actions effectively to ensure that</td>
<td>DFSA</td>
<td>18 months</td>
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<td>common issues—and root causes—or emerging patterns are identified in firms.</td>
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<tr>
<td><strong>Banking Regulation and Supervision</strong></td>
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<tr>
<td>Enhance systematic and prioritized approaches to confirm explicitly the</td>
<td>DFSA</td>
<td>Short term</td>
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<td>veracity of supervisory data and information received.</td>
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<tr>
<td>Conduct more frequent in-depth inspections of high-risk firms and use</td>
<td>DFSA</td>
<td>Ongoing</td>
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<td>inspections flexibly to respond to risks indicated in offsite work and</td>
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<td>external events.</td>
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<tr>
<td>Enhance skills—using external experts as needed—to intensify supervision of</td>
<td>DFSA</td>
<td>Short term</td>
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<tr>
<td>and give greater priority to non-financial risks (governance, risk culture,</td>
<td></td>
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<tr>
<td>IT risk etc).</td>
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<tr>
<td>Document risk interpretations centrally to enhance consistency and enable</td>
<td>DFSA</td>
<td>Under 1 year</td>
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<td>horizontal risk analysis.</td>
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<tr>
<td>Ensure corporate governance assessments include ‘top-down’ assessments; Issue</td>
<td>DFSA</td>
<td>Mid term</td>
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<tr>
<td>guidelines or an order to impose a requirement for the BoD to assess its own</td>
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<td>performance as well as the performance of the BoM.</td>
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<tr>
<td>In finalizing AML/CFT supervision projects, DFSA must take ownership of new</td>
<td>DFSA</td>
<td>Short term</td>
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<td>models and manuals; ensure the risk scoring model has an appropriate range of</td>
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<td>data and supervisory overlay; and establish systematic DFSA coordination on</td>
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<tr>
<td>AML.</td>
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<td>Broaden DFSA’s powers in relation to change of control, fit and proper reviews,</td>
<td>MIBFA/DFSA</td>
<td>Mid term</td>
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<td>financial holding companies, non-financial parent companies and related</td>
<td></td>
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<td>parties.</td>
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<tr>
<td>Recommendation</td>
<td>Responsible Authorities</td>
<td>Timing*</td>
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<tr>
<td>Require banks to factor liquidity and other risks into the internal pricing of their financial products.</td>
<td>DFSA</td>
<td>Under 1 year</td>
</tr>
<tr>
<td>Grant DFSA access to the external audit papers of the banks under its supervision.</td>
<td>MIBFA</td>
<td>Mid term</td>
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INTRODUCTION

A. Scope and Approach

1. This note presents a targeted review of selected aspects concerning the supervision of banking institutions in Denmark. The review was carried out as part of the 2020 Denmark Financial Sector Assessment Program (FSAP) and the findings and recommendations were based on the regulatory framework in place and the supervisory practices employed as of November 2019 – March 2020. They were also informed by insightful discussions with the Danish Financial Supervisory Authority (DFSA), the Danmarks Nationalbank (DN) banks, insurance companies, industry associations, audit firms, and other stakeholders in Copenhagen October-November 2019.

2. The mission focused on selected topics. The previous 2014 FSAP had conducted a full assessment of the Basel Core Principles for banking supervision. Building, therefore, on the previous work, the reviews of banking supervision focused on issues that were outstanding from the previous assessments and topics that were of particular relevance in the current environment. As the DFSA is an integrated supervisor, the discussion of the mandate, independence and resources is relevant to both banking and insurance supervision. With respect to the review of banking supervision, items open from the previous assessment, such as independence and resource of the supervisor, are accompanied by a consideration of the current state of art of the supervisory process, approach to use of supervisory powers, and a focus on the supervisory approach to various aspects of governance and control, including non-financial risks.

3. The IMF team wishes to thank the authorities and private sector participants for their excellent cooperation. The DFSA provided a self-assessment of compliance with the 2012 Basel Core Principles and responses to a complementary questionnaire. The authorities also provided a wide range of papers documenting supervisory practices and assessments. The FSAP review team benefitted greatly from the inputs received and exchanges of views during meetings with supervisors, banks, industry associations and other market participants. The team would like to thank the authorities for their excellent arrangements that have greatly facilitated the work of the mission.

4. This note is structured as follows. Following this brief introduction, the paper is in three main parts. The first of these chapters focuses on the mandate, independence and resources of the DFSA. The remaining two parts discuss, in turn, the review and findings of banking supervision and regulation.

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1 This note was prepared by Katharine Seal (IMF) and Jane O’Doherty (External Consultant).
DFSA: MANDATE, INDEPENDENCE AND RESOURCES

A. Background

5. **The Danish Financial Supervisory Authority (DFSA) is an integrated regulatory body.** It has the mandate for both prudential and conduct of business supervision and is responsible for the supervision of commercial banks, mortgage credit institution (MCIs), insurance companies, pension funds, investment funds, investment companies and brokers and others as well as the regulation of securities markets. Some responsibilities are shared with the Danmarks Nationalbank (DN) including the mandate for financial sector stability and oversight of payments systems.

6. **The DFSA’s tasks and responsibilities are conferred upon it by the Financial Business Act (FBA).** According to the FBA, section 344(1)(2), the DFSA is required to organize its activities with a view to promoting financial stability and confidence in financial undertakings and markets, and, for the insurance industry, to protecting the interests of policyholders. In particular, the DFSA is tasked with considering the viability of the business model of the individual undertaking as well as being required to have regard to the principles of materiality and proportionality. Denmark has exercised materiality discretion permitted in the EU Capital Requirements Directive IV (Article 99(2)) by setting a threshold of working capital of more than DKK 250 million (approximately USD 36 million) for an banks and mortgage credit institutions to be subject to an annual supervisory review process on solvency.

7. **The Danish transposition of EU legislation was up to date at the time of the mission.** EU regulations and national regulation are referenced and also set out in the FBA which provides the DFSA with its powers and which applies to banks. The DFSA can issue legally binding regulations – executive orders—under the provisions of the FBA and other legislation that applies to the financial sector. Furthermore, the DFSA can issue guidelines which are not legally binding, and which further elaborate its expectations, which is good supervisory practice. The guidelines are accepted by the industry as having de facto power of binding regulation. In terms of corrective or remedial actions or powers of intervention, the DFSA has a broad suite of powers within the sphere of banking supervision.

8. **Institutionally, the DFSA is an agency of the Ministry of Industry, Business, and Financial Affairs (MIBFA).** The supervisory authority is one of seven agencies which are under the aegis of the MIBFA.

9. **The Supervisory Board—governing body—of the DFSA is relatively new, having been in place only since 2014.** Appointments to the Board are made by the Minister of the MIBFA and are for a duration of two years only, although re-appointment is permitted. The Director General of the DFSA is appointed by the Minister who is obliged to consult the Supervisory Board to whom the Director General reports. The Supervisory Board is composed of 7 members: three of which with legal,

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financial and financial expertise, 2 with managerial background from the financial sector, 1 member with managerial background from the rest of the world and 1 member from the DN. The Chair and Vice Chair are drawn from these appointees. Additionally, the Minister appoints a Ministry observer to the Supervisory Board, with speaking, but not voting, rights.

10. **From 2020 appointees to the DFSA Board will be subject to enhanced scrutiny.** At the time of the mission there were few conditions relating to fitness and integrity that Board members had to satisfy, but new requirements were in force from January 2020. Amendments will bring the governance standards of the DFSA more in line with corporate culture – ensuring, for example, that relevant experience, criminal record, debts or professional disqualifications are explicitly taken into consideration before appointments can be made to the Board. A dismissal procedure for a Board member will be also introduced, albeit at the discretion of the Minister, as currently none exists.

11. **Conflict of interest standards for Board members will also be amended.** At the time of the mission, members of the Board of Directors and the observer may not be employed in or be members of the board of Directors for financial companies, companies that are part of a group of financial corporations, companies that have qualifying holdings, pursuant to the FBA, in financial companies. However, the new legislation will require that the chair and vice-chair may not have worked for a financial company or have been a member of the board for a financial company during the last five years before appointment to the DFSA Supervisory Board.

12. **The Supervisory Board is tasked with organizational and strategic roles as well as making decisions in supervisory matters which have significant and far-reaching consequences.** Furthermore, the Board approves executive orders and guidelines in areas where the DFSA is authorized to issue regulations. The board also provides technical, organizational and managerial assistance to the management team of the DFSA and approves the annual report of the DFSA. The tasks of the Supervisory Board are laid out in the FBA, section 345(7), and include:

   a. Approval of the organization of the supervisory body;
   b. Defining the strategic objectives of the DFSA’s supervisory activities and activities pursuant to part 17 and 17a, concerning planning of winding up and impairment and conversion of equity instruments;
   c. Approval of the annual report of the DFSA;
   d. Deciding on reactions in cases of principle and in cases which have significant consequences;
   e. Making decisions in cases of orders pursuant to FBA s. 347b (1), concerning impartial examination of one or more conditions in the financial undertaking;
   f. Deciding to hand over cases covered by no. 4 for police investigation;
   g. Approving rules and guidelines to be issued by the DFSA; and
h. Assisting the DFSA in the handling of cases under FBA chapters 17 and 17a which are not covered by (b).

13. The DFSA is funded through fees charged to the supervised institutions, but subject to budget restrictions imposed by the MIBFA and Ministry of Finance. Over recent years, funding for the DFSA has increased by more than 17 percent, though most of this is hypothecated to Anti-Money Laundering (AML). The previous FSAP of 2014 commented that supervisory resources were too low and the DFSA has undertaken a range of benchmarking exercises to probe a more acceptable range. Notably the prominent cases of money laundering have prompted more funding that is targeted for AML activity.

Comments

14. Due to the terms and conditions under which it has been established, the DFSA does not meet the international standards of an independent supervisory authority. The respects in which the DFSA’s operational independence are undermined fall into two broad categories: governance and resource. It may be noted that the 2014 FSAP shared this view on supervisory independence, and made some recommendations to enhance the operational independence of DFSA, which have been partially but not fully acted upon.

Governance Issues – Appointments and Dismissals

15. Appointments to the Board are made by the Minister and are of short duration. The 2014 FSAP recommended an extension to the very short—2 year—Board appointments and to introduce formal vetting process for Board members. No change has been made to the 2 year appointment period, though formal criteria for fit and proper standards are being put forward in the current legislative process. Dismissal processes for Board members are being introduced, but are at the discretion of the Minister. Conflict of interest provisions are already in place and cooling off-periods, are being increased to 5 years prior to taking up a Board position. While the extended cooling off period might unduly restrict the pool of credible candidates for the Board—noting that recruitment to these positions is already seen as challenging—the other changes seem unlikely to make a substantive difference. Ministerial ability to change the Board has been ratified, but consistency of tenure is not supported. While the formal introduction of experience and integrity criteria is welcome, it is hoped that in practice all the checks envisioned in the draft law were already taking place as a matter of due process. Best practice would argue that Board members’ term of service is disconnected from the political cycle and tenure extended to permit experience and expertise to develop.

Recommendations

- The Board appointment process should be moved to a broader parliamentary base and dismissal should be for reasons that are set out in law and publicly disclosed at time of dismissal. The tenure of appointment needs to be lengthened and disassociated from the political cycle.

- The reasons for the dismissal of a Director General should be clearly stated in law and publicly disclosed in the event a dismissal should ever take place.

- The cooling off period prior to assuming a Board position should be reviewed at the next opportunity and revert to its previous level.

Governance Issues – Responsibilities

16. **Given that the Board are Ministerial appointees, and include an observer from the MIBFA, care is needed in the handling of operational matters.** The tasks of the board go beyond the expected setting the strategy and ensuring that the executive delivers according to a clearly articulated plan of action. The Board is involved in topics of principle in interpreting the parameters of the FBA and how the DFSA may use its powers of action, and it is involved in the operational design of the DFSA. There is, inevitably, a blurred line between strategic and operational issues, particularly when the Board needs to opine on whether the DFSA is acting within the limits of its legal powers. It should also be borne in mind that if the Board directs the DFSA not to pursue an action and subsequent events indicate that the DFSA should have used its powers to intervene, it is the Board rather than the DFSA that should be held accountable.

Recommendations

- To signal operational independence, the MIBFA representative should no longer sit on the board, and a regular meeting between the Director General and the MIBFA should replace it.

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**Box 1. Denmark: Financial Technology and the DFSA**

**In 2017 the DFSA established a dedicated fintech (financial technology) team with a government mandate and funding.** The creation of the unit is consistent with the desire by the Danish government to create a supportive environment for fintech startups. The team offers ‘handheld supervision’ acting as a liaison between the licensing team and the fintech firms, to provide guidance for companies that are unfamiliar with financial and prudential requirements. The team has also established a sandbox initiative (FT Lab), where selected companies have the opportunity to test out their technologies and business models in a secure environment. While to date there has been a limited number of fintechs coming through the DFSA in the banking space, and the unit may currently be under-utilized, the structures in place to support these initiatives at the DFSA is a welcome initiative and awareness raising needs to continue throughout the staff.
The Resource Challenge

17. Resource burdens have been increasing for supervisors globally and the DFSA is not spared from this pressure. There has been a steady onslaught of new regulation for the past ten years and the flow will continue for at least a further 3 to 5 years as the European Union legislative process steadily finalizes the regulations and directives required to deliver the international reform agenda following the global financial crisis. While the EU has many important and valuable ancillary processes to further iterate and support good quality implementation, for example in the banking field stemming both from the work of the European Banking Authority (EBA) and the supervisory activities of the European Central Bank (ECB) in the context of the single supervisory mechanism (SSM), the burden implied by the requirement or expectation that supervisors take account of or even fully adapt their approaches to keep up with these developments is significant. Furthermore, new risks and challenges are emerging which demand the evolution of the supervisory process and acquisition of new skills for example, the challenges of cyber resilience, the potential opportunities of fintech or the growing sophistication of threats from criminal activity (money laundering and terrorist financing). Putting these factors together, the DFSA faces pressure both for numbers of staff to adequately deliver its supervisory activities as well as the right suite of skills.

18. Recruitment and retention of a high caliber of staff equipped with an increasing range of specialist skills is critical to the DFSA’ supervisory mandate. The problem is well understood, but not easy to address. For some of these skills, such as cyber specialism, or actuarial science, the DFSA must compete in thin and expensive markets. Even for more traditional skillsets the DFSA needs to be attractive enough to retain staff as they gain experience and seek career advancement. To meet the recruitment challenge, the DFSA has positioned itself as an excellent choice for talented individuals as the first step on their career ladder. There is much to recommend this strategy, but the risk is that the DFSA may put itself on a treadmill of recruiting good quality staff but, unable to retain them, is constantly having to meet the challenge of training new arrivals rather than reaping the benefits of having more seasoned, experienced staff. Being able to offer career progression, status and salary are critical to developing a “middle” range of staff, who are notable by their almost complete absence from the DFSA complement of staff. Moreover, a high turnover of staff places yet more burdens on training, development and knowledge management. Industry consistently expressed concern at the high numbers of junior staff, who, despite their quality, were still learning their profession.

19. The DFSA does not have complete discretion in how funds are allocated within the overall budget. Recent increases to resource for AML and the establishment of the fintech unit illustrate that funding can, to a greater or lesser extent, be hypothecated to particular uses which may or may not match the DFSA’s own analysis of its most pressing needs. Adding to the complexity of determining the requisite resource needs is identifying meaningful and appropriate benchmarks – in terms of numbers, practices, skill mixes. The DFSA has done recent work on benchmarking itself against some EU peers and is encouraged to continue in this work. While the Nordic jurisdictions are a natural peer group, it is also important to consider approaches that are being pioneered in a wider range of jurisdictions or there is a risk of circular feedback mechanisms. Considering the sometimes
very different (in style, organization, funding and operational activity) of other jurisdictions will be valuable for alternative insights and stimulation.

20. **The DFSA cannot set its annual budget independently but is dependent on the MIBFA and the Ministry of Finance, although funding is levied from the industry.** In some jurisdictions, central banks have surplus budget appropriated to central government funds, even where the central bank is judicially independent. However, a system where constraints are set by the government that burdens the industry for the funding, does not isolate the supervisory authority from the influence of either government or industry, both of whom play a critical role in the funding and noting that industry has the ability to lobby government to keep cost and regulatory burdens down. It may not be viable to amend the funding model of the DFSA as a direct levy might not be permitted under Danish law (such rights being reserved to government) but the resource envelope should be expanded.

**Recommendations**

- An expanded budget envelope is recommended. Resources need to be deployed to enhance the DFSA as a career option for specialists and talented mid-career staff. Resource also needs to be expended in enhanced internal audit and risk management function for the DFSA itself. Continued investment in IT resources to harness the maximum analytical potential from the data that is being collected by the DFSA and generated by the DFSA is essential and will need continued and potentially elevated funding.

- If additional resources cannot be agreed for the DFSA, then there needs to be a clear communication between the DFSA and the MIBFA, to be made public, to ensure that the DFSA is held accountable but not held against unreasonable expectations. What the DFSA can deliver according to a risk based approach within any specific budget envelope needs to be clearly articulated. The development and publication of a risk appetite statement by the DFSA would be beneficial in this regard.

- Related to the need to articulate a risk appetite statement, it is welcome that the DFSA has established an internal audit function that can comment on this statement. However, the internal audit function appears under-resourced particularly given that it is a new function which needs to establish and supporting the needed embedding of a risk management framework and workplan to meet expectations.

- In view of scarcity and expense of specialist skills, the DFSA is also advised to supplement its risk expertise by making more use of external experts with the necessary skills and independence to support its work. This would be particularly beneficial for the newer risk areas where the DFSA is building capabilities. However it may also be useful to prove additional capacity for targeted deep-dive assessments over a shorter timescale than DFSA could achieve with its own resources.
BANKING REGULATION AND SUPERVISION

A. Market Structure

21. Denmark’s financial system is large relative to GDP, standing at assets over 600 percent of GDP. The banking sector—comprising 76 banks and mortgage credit institutions (MCIs)—accounts for 60 percent of financial sector assets and is large in comparison with other countries. The banking sector is dominated by seven domestic systemically important financial institutions (D-SIFIs); the largest is the Danske Bank Group (with assets of about 170 percent of GDP). Insurance companies and pension funds (ICPFs) are also large relative to European peers (200 percent of GDP) partly due to the fact that life insurers are major providers of occupational pension plans. ATP is the dominant provider of pension savings outside the insurance sector.

22. The Danish banking sector comprises Commercial banks, Credit Cooperatives and Savings Banks. The latter two sectors have mutual ownership structures but under the Financial Business Act any new banking entity must have a limited liability structure, though conversion of the mutual sector is not compulsory. As of end-2019, there were 654 commercial banks, credit cooperatives and savings banks in Denmark. All Major D-SIFI group structures incorporate both a commercial bank and MCIs. Both banks and MCIs are authorized to issue covered bonds to finance mortgage portfolios. The major groups account for the majority of total lending in Denmark and the sector is not only among the largest in Europe relative to GDP but also among the most concentrated.

23. The Danish SIFI designation is updated annually by the DFSA and carries with it a capital surcharge. The buffer requirement is one to three percent of risk weighted assets, depending on degree of systemic importance which must be met by common equity tier 1 capital. As of June 2019, the SIFI groups in Denmark: are Danske Bank, Nykredit Realkredit, Nordea Kredit Realkreditaktieselskab, Jyske Bank, Sydbank, DLR Kredit and Spar Nord Bank. There are two SIFIs in the Faroe Islands and one in Greenland. SIFI designation is based on meeting at least one of the following quantitative criteria in two consecutive years:

- Balance sheet greater than 6.5 percent of GDP (Greenland: 65 percent and Faroe Islands 13 percent);
- Lending greater than 5 percent of total sector lending;
- Deposits greater than 3 percent of total sector deposits.

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4 At the end of 2019 there was also one bank in Greenland and 4 in the Faroe Islands.

5 In Greenland and the Faroe Islands the thresholds are higher than in Denmark, i.e., Greenland: Balance sheet greater than 65 percent of GDP, lending greater than 50 percent market share and deposits greater than 50 percent. Faroe Islands: Balance sheet greater than 13 percent, lending greater than 50 percent and deposits greater than 10 percent.
24. The Danish banking system is highly connected with the Nordic and, to a lesser extent, the Baltic systems. The operations and exposures of major Nordic banks are concentrated in the Nordic-Baltic region. Banking services are typically carried out through the EU passport in branches. Nordea, until November 2018 designated as a Global Systemically Important Bank (GSIB) based in Finland, has a systemically important branch in Denmark, as do Svenska Handelsbanken and SEB from Sweden. Other Nordic banks have only a small presence. Danske bank has significant operations across the Nordic region via its MCI subsidiaries and commercial banking branches making Denmark, with the exception of Nordea, more significant as a home than a host jurisdiction.6

25. The performance of the banking sector is stable though there are some elements of pressure. Capital and liquidity ratios are above minimum requirements, and while net interest margins are being squeezed, ROE remains above the weighted EU average published in the EBA Risk Dashboard (see chart).

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6 The geographic breakdown of Danske bank’s exposures is as follows (in percent): Denmark (52), Sweden (15), Norway (11), Finland (9), UK (4), Baltics (1), rest of Europe (7), and other (2). Danske’s Estonian branch was closed in 2019.
B. Institutional Safety Net

26. The DFSA and the Financial Stability Company (FSC) are the designated resolution authorities under EU legislation. The Danish transposition of the BRRD empowers the FSC to apply resolution tools and the FSA to exercise certain resolution powers. For systemically important institutions, however, the Minister of Industry, Business and Financial Affairs determines the choice of resolution tools. Resolution plans for systemic groups are developed in close cooperation between the FSC, the Danish central bank (Danmarks Nationalbank (DN)), and the DFSA. The three organizations cooperate in developing resolution plans for systemic groups.

27. A Systemic Risk Council (SRC) was established in February 2013. An advisory body, its task is to address systemic risks in the financial area, including areas which may not necessarily be subject to regulation. The SRC’s, like that of the European Systemic Risk Board (ESRB) is asked 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 MIBFA. Membership of the SRC is drawn from several authorities: the DN (one being the chairman of the DN Board of Governors and who chairs the SRC); two DFSA representatives; one representative each from the Ministry of Industry, Business and Financial Affairs and Ministry of Finance; and three independent experts.

28. The Danish Guarantee Fund (Garantiformuen - DGF) is the Danish deposit guarantee scheme. In common with other guarantee funds across the EU, under the Deposit Guarantee Directive, protection is provided for eligible deposits up to an amount equivalent to EUR 100,000 per depositor. The DGF is administered by Finansiel Stabilitet (FSC) which is an independent public company owned by the Danish State through the MIBFA. At the time of the mission, the DGF managed assets equivalent to 1.25-1.5 percent of the covered deposits in Denmark. Should the level of the fund fall below 0.8 percent of covered deposits, institutions must provide further top-up funds. The resolution fund (Afviklingsformuen) is also administered by the FSC and is funded in the same way as the DGF, but currently only manages 0.4-0.5 percent of the covered deposits in Denmark, with a target of 1 percent.

C. Supervisory Approach

Risk Assessment and Planning of Inspections

29. 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 vary between one and five years. One of the recommendations of the 2014 FSAP was that the supervision cycle for sound and well-capitalized

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7 Directive 2014/59/EU of 15 May 2014 on Bank Resolution and Restructure (BRRD) Articles 3(10) and 3(11).

medium and smaller banks should be shortened from once every four to six years. The examination cycle has been slightly shortened, with ordinary inspections now scheduled every four to five years. For the largest, non-systemic banks with a high risk assessment an ordinary inspection takes place every two years as well as an annual inspection of the banking book (bank credit review). In the case of a high risk systemic institution, the DFSA would take a decision on how to intensify supervision reflecting the systemic importance of the firm.

30. The frequency of inspections is determined by the bank’s size and the outcome of the DFSA’s risk assessment of the bank. The risk assessment begins with a mechanical slotting according to five quantitative financial risks which the supervisor can then modify up or down based on their knowledge of the specific institution. The risk assessment is then mapped to a table where banks are categorized by size on the basis of their capital requirement. The table sets out the default inspection frequency although it may be adjusted by supervisors should they deem that appropriate.

31. The DFSA has made increasing use of ‘themed inspections’ to focus on specific risk areas of interest. A recommendation from the 2014 FSAP was that onsite inspections should be used 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, indicated a likelihood that another onsite examination would be needed. Since 2014 the number of themed inspections, where a specific theme is assessed across a sample of entities either on an on- or off-site basis, has increased from 9 in 2014 to 74 in 2018.

32. The DFSA’s supervisory approach has a strong focus on traditional financial risks and credit risk in particular. The individual risk assessments of banks undertaken by supervisors has a very strong focus on traditional financial risks. The default response to high risk assessments for small, medium and large banks is to immediately focus on credit by scheduling a bank credit review every year (as well as reviewing other relevant risks) and an ordinary inspection of all key areas every two years (for large and medium banks); or every three years (small banks). The DFSA and stakeholders confirmed that the key risk for the DFSA in supervising banks is credit risk.

33. The ‘supervisory diamond’ is another important part of risk-based supervision which the DFSA uses to identify banking activities which should initially be regarded as having a higher risk profile. The diamond establishes a number of financial limits, again with a strong focus on credit risk, which banks are expected to operate within for a number of quantitative risk areas. Those risk areas relate to large exposures, funding, liquidity, commercial property exposure and lending growth. The limits are intended to counteract excessive risk-taking but to continue to allow resilient banks to carry out profitable banking activities and to offer the credit required to undertakings and households. In 2018 a separate supervisory diamond for MCIs was also established.

Comment

34. The DFSA’s central focus on credit risk may mean that other key risks are not given appropriate scrutiny. Whilst credit is undoubtedly critical to the health of Danish banks and mortgage credit institutions, there are a number of other risk areas that may threaten the financial
stability of these entities. The strong emphasis on credit risk may provide misplaced supervisory comfort about the health of an entity which would be revealed if other risk areas were given equal scrutiny.

35. **Despite the strong emphasis on the assessment of quantitative financial risks, the DFSA’s ability to assess and challenge institutions on their non-financial risks is not as evident.** While the DFSA prioritizes aspects of governance and compliance risks, discussions within the DFSA and with other stakeholders indicated that supervisory engagement on top-down governance issues and end-to-end analyses of processes as well as other non-financial risks including conduct, reputational risk, compensation practices and risk culture were not key areas of focus in supervisory discussions and inspections. Non-financial risks are also not given significant prominence in the individual risk assessments of banks.

36. **There is a risk of inconsistent risk-scoring in the individual bank risk assessments.** In recent years, the DFSA has enhanced and adjusted its risk assessment process in line with the SREP Guideline prepared by the EBA and there is also some guidance prepared for supervisors to assist them in making their individual bank risk assessments. However, there is no detailed guidance on ‘what good looks like’ for the different risk ratings, nor what weightings to give different risks in reaching the overall assessment conclusion, notwithstanding manager oversight and review. Two different supervisors could assess the same bank differently depending on what risks they place more importance on or how conservatively they might rate a particular risk. Furthermore there are no formal quality assurance processes in place for risk assessments.

37. **Whilst the increase in themed inspections is a welcome initiative, additional capacity and flexibility for onsite inspections would enhance supervisory oversight.** The increase in themed inspections doesn’t fully address the 2014 finding which also considered the need to follow up with onsite reviews of individual banks where there were specific concerns. When this recommendation was made it was acknowledged that additional resources would be needed in order to make these kinds of adjustments. The recommendation remains valid.

**Recommendations**

- The DFSA should seek to complement its strong skills and focus on credit risk with equal rigor and focus on other risk areas. In particular the DFSA should ensure that the default inspection schedule for high and above average risk assessments is not skewed towards a focus on credit risk at the expense of other key risk areas. In particular large entities with a high risk assessment should be subject to a more in-depth inspection on a shorter cycle than every two years.

- There is scope for the DFSA to sharpen its supervision of non-financial risks. Shortcomings and failures in the management of these risks were a key contributing factor to the financial crisis. They are also central to more recent failings at financial institutions. The prudential supervision of these risks is undoubtedly a challenging area that does not easily lend itself to quantitative tools or limits. Increasingly however, supervisors have recognized that these are risks that need to be given appropriate scrutiny and review as part of ongoing prudential engagement. In particular,
non-financial risks should be given more prominence in the bank risk assessments. In support of a sharpening of the supervision of non-financial risks the DFSA should also seek to lift its capabilities and resources in these areas.

- The DFSA should develop more detailed guidance on risk assessments to support supervisory judgement and ensure consistent outcomes. While the DFSA places importance on the manager review of individual risk assessments to ensure consistent outcomes, this reliance is subject to risk in itself and is not the optimal approach to ensure quality assurance. Articulating and documenting guidance using examples and clear parameters will more effectively support supervisory assessments and consistent ratings. Such an approach would also provide a basis on which to develop a quality assurance regime. More detailed guidance would also be particularly useful given the reasonably high turnover of junior staff and the need to train new supervisors on an ongoing basis.

- With additional budgetary resources, the tool of the onsite exam should be used more flexibly to respond to findings from offsite processes and external events that may indicate a heightened risk concern.

**Supervisory Techniques**

38. **The supervisory activity of the DFSA can be described as a mix of off-site and on-site supervisory activity.** The key supervisory activities are:

- Continuous surveillance through the off-site review of data;

- Themed inspections where supervisors select a sample of banks and focus on a specific risk area. Themed inspections may be on- or off-site;

- Functional inspections which focus on a specific institution and a specific risk for onsite review; and

- Ordinary inspections are conducted onsite and cover all relevant risk areas within an institution. It should be noted, though, that the COVID-19 pandemic required some ordinary inspections to be conducted off-site by videoconference.

- For SIFIs ordinary inspections are not conducted, instead a series of functional inspections are held on a rolling basis, such that all risk areas that are considered relevant are covered in an inspection cycle. Line supervisors of SIFIS have much more frequent interaction with institutions, including through regular meetings with management and risk functions. The DFSA also receives minutes from board meetings and board committees on an ongoing basis.

39. **Since 2014 the number of themed inspections has increased** from 9 to 74; the number of functional inspections has increased from 15 to 27; and the number of ordinary inspections has decreased from 26 to 20.
40. **Continuous surveillance is primarily done through quarterly data analysis.** Supervisors receive standardized data packages and peer reviews to facilitate benchmarking across entities. Quarterly key risk indicators are also presented for monitoring purposes at a standing bank committee in which the executive board participates. The monitoring identifies banks with the highest risk position, exposure composition or performance within each key risk indicator. The risk areas covered span capital and liquidity positions; P&L figures; exposure composition and concentration; impairments and credit quality indicators; and market risk indicators etc. For the largest banks, line-supervisors receive information more frequently, including board minutes, audit and risk management reports. If the monitoring shows unexpected movements or the need for intervention, the committee ensures that the DFSA reacts and takes the necessary supervisory actions towards potentially challenged or unhealthy banks.

41. **Ordinary inspections are always conducted on-site with all relevant aspects of an institution reviewed.** On-site inspections are arranged in different manners depending on whether all risk areas or selected risks are inspected. In general, all risk areas are inspected during on-site inspections in small and medium sized institutions, whereas the on-site inspections in large institutions are arranged around the inspection of selected risk areas. For low risk areas, or areas where supervisors are satisfied based on material received, onsite meetings are not held. For the largest institutions ordinary inspections covering all business areas are not conducted, all areas are instead covered through a series of functional inspections. The process for functional and themed inspections vary depending on the type and content of the inspection. These inspections can range from a process akin to continuous surveillance for a themed inspection taking place entirely off-site, to something more like an ordinary inspection for certain on-site functional inspections.

42. **The DFSA has spent considerable effort since 2018 documenting its internal policies and procedures.** This has included a formal, documented process for the planning and execution of on-site inspections and off-site activities. These processes clearly set out the steps to be included as part of the inspection and include suggested agendas for stakeholder meetings. Following ordinary inspections and in some cases following themed and functional inspections, a long-form report containing observations, findings and supervisory reactions is prepared and presented to the bank. In addition, a short-form summary of the observations and conclusions is published by the institution and the DFSA on their respective website.

**Comment**

43. **The internal documentation of DFSA processes has been a significant piece of work.** As the DFSA increased in size over recent years, there was an increasing recognition that the institutional knowledge and ‘way of doing things’ needed to be recorded in an accessible way. Staff within the DFSA have repeatedly voiced support for the usefulness of the exercise. It was noted that the new policies and procedures are particularly helpful for new staff members.

44. **As part of both on- and offsite supervisions, supervisors receive attestations from banks and their personnel on various matters.** Supervisors also receive frameworks, reports, policies, procedures and other documents from banks as part of their ongoing supervision. The DFSA seeks to
verify what has been attested to when they undertake their onsite inspections. Notwithstanding, discussions with supervisors and stakeholders suggest that in many instances the DFSA places reliance on firms’ attestations without further verification, and this is inevitable, given the constraints on the frequency of inspections. Whilst the supervisor must to some extent rely on banks to deal openly and honestly with them, this may not always occur. Furthermore banks may believe the information they submit about their risks to be accurate but may themselves be unaware of risk failings in practice.

45. **Much of the coordination, consultation and cooperation across divisions within the DFSA continues to rely on informal interactions.** There is a strong sense of trust among colleagues and the informal ways in which engagement takes place is a strength of the organization. However the reliance on informal interactions creates risks for the organization when these interactions do not take place. Gaps in communication is something which can easily happen during busy periods; or when staff change; or when colleagues are not sure when and who they should contact in different situations. The DFSA explained that it was working on a policy to enhance internal coordination, as well as an update of the role of expertise centers. This work began in the summer/autumn 2019, with a planned completion date of spring 2020. The policy will address organization and coordination of supervision by divisions working on the same institution.

46. **The DFSA does not explicitly require banks to take into account liquidity impacts in their reviews of internal pricing.** The 2014 FSAP recommended that as part of assessing whether banks appropriately account for risks, banks should be required to ensure that liquidity and other risks are factored into the internal pricing of financial products. This recommendation has not been addressed and still stands.

**Recommendations**

- The DFSA’s supervisory oversight may benefit from a greater focus on checking banks representations and following up on how frameworks and policies apply in practice with more periodic ‘end-to-end’ reviews of selected processes. Supervisors must be able to trust their entities to a certain extent, but prudence suggests a ‘trust but verify’ approach may be most fitting.

- As the DFSA grows in size it is becoming more important that consideration be given to formalizing some of the ways in which colleagues engage with each other. The introduction of formal ‘liaison officers’ between the Economic Secretariat and other parts of the DFSA is welcome but there is scope to further formalize interactions. The work on developing the internal coordination and organization policy is therefore extremely important. This should not impede the strong collegiate culture of the organization, rather it should help to reinforce those bonds. At the same time, more formalized touchpoints should enhance transparency; ensure a more consistent approach to engagement; and mitigate the risks associated with staff turnover and key person risk.
**Risk Expertise**

47. The DFSA’s specialist risk expertise for banking supervision is dispersed across the organization in numerous ‘centers of excellence.’ There are different types of centers of excellence some with more supervisory focus and some with more regulatory focus. Some risk experts sit in dedicated risk teams, others operate from within supervision teams and may be fully or only partly dedicated to providing risk expertise. There are more than 40 centers of expertise although in some cases the same risk is dealt with in more than one center of excellence. Supervisors may seek advice from the risk experts in relation to their entities and in some cases the risk experts will accompany the supervisors on inspections to focus on specific risks.

**Comment**

48. Risk decisions, advice and interpretations are not consistently documented in a centralized way. Whilst advice on a particular entity will be noted on the individual bank files, there is no horizontal capture of the risk advice given. Where a risk is dealt with in more than one center of excellence there are no formalized mechanisms to ensure consistency between the two. This can lead to inconsistent outcomes, silo-ed approaches and duplication of effort.

49. Risk advice is typically provided at the request of supervisors. In at least some centers of excellence the risk expert only provides advice on an entity when this is sought by the supervisor. Whilst this is an important aspect of the role there is a risk that the supervisor may not always recognize or flag the need for additional expertise to the risk center of excellence. Furthermore risk advice provided by a risk expert does not have to be followed by the supervisor. Apart from inconsistencies in approach this also creates a risk in itself if expertise is not followed. While the DFSA has a strong expectation that supervisors will identify risks and follow advice when sought there is no mitigation in place should this not occur.

**Recommendations**

- The DFSA should document the risk interpretations and advice given in a centralized way to enhance consistency and allow for the development of horizontal analysis of the risk. While the DFSA places importance on each center of excellence liaising with other relevant centers of excellence to ensure consistency this appears to be an informal expectation which does not consistently occur. More formalized expectations of collaboration and improved documentation of risk decisions would improve consistency in this area. Improved documentation would also allow for horizontal analysis of the risks including identification of risk concentrations and emerging areas of concern.

- Risk centers of excellence should both proactively and reactively provide advice, analysis and support to supervisors. Ensuring that risk experts horizontally analyze data allows for the identification of risk trends and concentrations that supervisors may not be able to identify at an individual entity level. Risk experts should also be obliged to flag to management where their advice has not been taken so that this can be documented and followed up if necessary.
Supervisory Reporting

50. **The DFSA receives a significant amount of data from its banks as part of ongoing supervision.** The regular data comes from submissions based on common European templates developed by the European Banking Authority (EBA); and reporting based on national templates designed by the DFSA for supervisory purposes. The DFSA considers that they receive all the data needed for off-site surveillance and risk based supervision, such as financial statements, capital adequacy, liquidity positions and funding, large exposures, asset quality, market risk, stress testing outcome etc. Using the data submitted, the DFSA is able to perform and facilitate comparisons and benchmarking between banks and banking groups. There is a user-friendly interface for supervisors to see the data from their supervised entities and to perform some analyses and peer comparisons. Charts and excerpts from this system are included as part of the individual risk assessments.

Comment

51. It is critical that all supervisors, including the DFSA keep pace with advancements in data, analytics and technology so they can leverage supervisory data as effectively as possible. Strong data analytical capabilities can be a powerful tool for supervisors to support them in their work. In addition to the data submitted by supervisors the DFSA also creates data through its own supervision which can also provide useful insights.

Recommendations

- The DFSA should prioritize and increasingly invest in its internal IT/data systems to support supervision’s analytical capabilities. In this regard the recent establishment of an Analytical Center of Excellence (ACE) and a Data Operations Team (DOT) are welcome developments. Whilst there has been work to enhance the tools available to supervisors to support their work, continuous investment in technology will allow the DFSA to keep pace with the data capabilities of its supervised entities. Although some horizontal analysis takes place, increasing the extent to which it is undertaken across risks, entities and industries may better allow supervisors to identify trends and emerging risks. Enhancing data analysis on non-financial risks will also support work in this area.

- Data analytics should focus not just on entity data collected but also on the data created by the DFSA itself. In addition to analyzing entity data the DFSA should leverage its own supervisory work to identify trends and emerging risks. For example a comprehensive analysis of orders given within and across industries could provide useful insights and trends and indeed is something that anecdotally we understand industry sees value in and already does to some extent. As mentioned earlier, a central recording of risk interpretations and advice would reduce the risk of a siloed approach to risk and reduce inconsistency in approach. Better capture across the DFSA of internal risk data could also facilitate a more complete picture of the risk profile of a bank to emerge.
D. Supervision of Specific Risks

Corporate Governance

52. **Denmark has a two tier management system.** The Board of Directors (BoD) takes part in the overall and strategic management of the institution and supervises the senior management, known as the Board of Management (BoM). Corporate governance requirements for banks are primarily set out in provisions in the FBA; the DFSA’s *Executive Order on Management and Control of Banks* (EO-MC); and for companies listed on the stock exchange, the ‘Recommendations on Corporate Governance.’ The Danish Bankers Association (Finance Denmark) has also issued a set of corporate governance recommendations for its member companies.

53. **The division of responsibilities between the BoD and the BoM is set out in the DFSA’s EO-MC.** As part of its overall management and strategic management duties the BoD must ensure that there is effective control over the bank’s entire business and that appropriate policies are in place. This includes the duty to ensure adequate risk management and internal control procedures. The BoD is also obliged to make decisions regarding the overall strategic objectives of the bank for the relevant risk areas, including its risk appetite, and to instruct the BoM on how the strategic objectives should be achieved. The BoD must ensure it receives appropriate reporting and management information to be able to assure itself that the undertaking has effective forms of corporate governance. As part of its responsibility for the day-to-day management of the bank, the BoM must ensure that the bank complies with the policies agreed by the BoD.

54. **Members of the BoD and BoM as well as key function holders are required to meet certain standards with regard to fitness and propriety.** In accordance with Section 64 of the FBA, the DFSA must assess whether members of the BoD and BoM meet fit and proper standards. Banks must also identify staff with responsibility for a key function eg: head of compliance, head of internal audit; and these ‘key function holders’ must also be assessed by the DFSA for fitness and propriety. The BoD is also required to regularly assess whether it has the adequate skills, knowledge and experience to carry out its tasks. The DFSA reviews these assessments as part of its ordinary inspections. In relation to the establishment of board committees Denmark has implemented the European Directives including the provisions on requirements for nomination, risk, audit and remuneration committees.

55. **The BoD is obliged to regularly assess the performance of the BoM.** In accordance with paragraph 70(1) the BoD of the banks should regularly assess whether the board of management is

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9 The Committee on Corporate Governance is an independent committee established by the Danish Ministry of Industry, Business and Financial Affairs. The Committee has produced a set of recommendations on corporate governance for companies admitted to trading on the Nasdaq Copenhagen A/S. Compliance with the recommendations is on a ‘comply or explain’ basis. [https://corporategovernance.dk/english](https://corporategovernance.dk/english)

performing its duties in line with the risk profile and policies laid down, as well as the guidelines for the board of management. The BoD is obliged to take appropriate steps if this is not the case.

56. **The FBA establishes compensation principles for board members and material risk takers.** Section 77(a) of the FBA establishes a number of compensation principles for the BoD, BoM and material risk takers,\(^{11}\) that are designed to ensure an appropriate compensation policy is established which supports the bank’s long run safety and soundness and discourages excessive risk taking. These include maximum levels of variable compensations to base salary (50 percent), minimum proportions of equity to overall variable compensation (50 percent); and the use of deferred payments (40 - 60 percent over three year periods, depending on the amount).

57. **New legislation requires the adoption of a written policy that ensures and promotes a good, healthy business-culture within the company which the BoM must ensure is implemented and complied with.** In May 2019, the Danish Parliament passed a bill implementing a number of changes in the financial sector including amendments to the FBA introducing requirements related to a banks’ business culture. According to FBA s.70a, a bank’s policy should establish the overall framework to facilitate a healthy business culture at all levels in the organization. The policy should promote high ethical and professional standards, taking into account the specific needs and characteristics of the company. Furthermore, the policy should also support a business environment that encourages open communication and stimulates a sound, critical attitude among employees towards behaviors linked in particular to financial misreporting, misconduct, economic and financial crime (including fraud, money laundering and anti-trust practices etc.).

**Analysis and Recommendation**

58. **The DFSA’s assessment of a bank’s compliance with the EO-MC is considered to be a main element of on and off-site inspections.** As part of these inspections, the DFSA reviews the rules of procedure of the BoD; minutes of the meetings of the BoD; and the BoD’s self-assessment required skills and knowledge. The DFSA also regularly meets with the Chairman of the BoD; the BoD; and key function holders. The frequency of the reviews/inspections and meetings are planned on the basis of the DFSA’s risk assessment both of the institution and more broadly.

59. **The DFSA has a team that specializes in corporate governance and remuneration.** The six-member team’s key focus areas are fit and proper assessments; remuneration and ongoing policy and legislative work. For the most part however, supervisors take the lead in reviewing and assessing corporate governance within banks. The specialist team are nonetheless available to supervisors should they need additional support. Although remuneration data is reviewed by the specialist team, more in-depth analysis such as the drivers and incentives remuneration frameworks create within an organization does not appear to be an area of focus.

\(^{11}\) Section 77(a)1 of the FBA applies to ‘other employees whose activities significantly influence the risk profile of the undertaking’ (material risk takers).
60. The DFSA’s assessments of corporate governance in banks tend to focus more ‘bottom-up’ than ‘top-down.’ The DFSA and its stakeholders indicated that apart from ‘fit and proper’ assessments, the DFSA focuses mainly on corporate governance as it relates to specific risk areas eg: governance of the credit risk area, rather than a broader, more holistic assessment. Whilst a ‘bottom-up’ approach is important it is also beneficial to carry out ‘top-down’ analysis looking at the functioning and performance of both the BoD; the BoM and key function holders. Discussions within the DFSA and stakeholders suggested that robust ‘top-down’ discussions on governance matters are not as common. Whilst the FBA requires the BoD to assess the performance of the BoM there is no legal requirement for the BoD to undertake an assessment of its own performance. Where some entities have undertaken a BoD assessment to meet stock exchange recommendations, there was no evidence that supervisors discussed these assessments with the BoD.

61. The DFSA does not appear to have the full skillset to address the new business culture requirements. The new amendments to the FBA related to business culture will require upskilling of staff and/or new resources to ensure that the DFSA can satisfy itself that banks are meeting the requirements. These areas can be complex to assess and their effective implementation and assessment is multi-faceted.

Recommendations

- The DFSA should issue guidance, or an executive order requiring the BoD to assess its own performance. This would be consistent with the Basel Committee’s corporate governance principles for banks12 (the Basel CG Principles). Principle 3 of the Basel CG Principles states that to support its own performance, the board should carry out regular assessments – alone or with the assistance of external experts – of the board as a whole, its committees and individual board members. This should include an assessment of “the ongoing suitability of each board member periodically (at least annually), also taking into account his or her performance on the board.” As noted in paragraph 157 of the Basel CG Principles, “the board and senior management are primarily responsible for the governance of the bank, and supervisors should assess their performance in this regard.” While discussion on board performance may happen as part of the supervision of some Danish banks, it was not clear that this was happening as a matter of course and in a consistent way across institutions.

- It is recommended that the DFSA complement the ‘bottom up’ approach to corporate governance by also consistently reviewing from ‘top-down.’ Corporate governance is the set of relationships between a company’s management, its board, its shareholders and other stakeholders and as such, it is important to assess it holistically. The board should set the ‘tone at the top’ and supervisors should be willing and able to engage and probe the BoD and BoM on their performance and oversight of the bank.

- The DFSA should upskill in the new areas of focus set out in the FBA, in particular in relation to business culture. Ensuring that entities meet these requirements will require new skills across the

12 https://www.bis.org/bcbs/publ/d328.pdf
DFSA, which should be acquired and developed to ensure an appropriate supervisory oversight of the new requirements.

Internal Controls and External Audit

Financial Reporting, Internal and External Audit

62. **External auditors that sign audit reports for banks under DFSA’s supervision need to be certified by the DFSA.** Certified auditors need to evidence 750 hours of audit work from at least three different banks within the previous five years, as well as meeting an ongoing education requirement. There are currently 39 approved individuals; of those 39, 29 are currently signing audit reports for banks; representing four audit firms in total.

63. **The DFSA does not have access to the working papers of banks’ external auditors.** The 2014 FSAP recommended that the DFSA should seek to have such access but this has not occurred. The Danish Business Authority is the competent authority for the oversight of auditors and the DFSA does not wish to interfere with this competence by also seeking access to papers. Notwithstanding, the DFSA has intensified its cooperation with the Danish Business Authority in recent years. This cooperation has included a legal analysis of the extent to which information may be exchanged on external auditors between the DFSA and the Danish Business Authority. Notwithstanding, this issue remains valid as a recommendation.

64. **Audit and risk management reports of SIFIs are automatically received by the DFSA when they are completed.** The 2014 FSAP recommended that these reports should be received on a flow basis as this was not happening at that time. Reports from non-SIFIs are not received on a flow basis.

65. **There is no explicit requirement for fair value estimates to be subject to independent verification and validation.** The 2014 FSAP recommended that there be a requirement but this has not been implemented. The DFSA notes that valuations for significant assets will be audited by the external auditors as part of their audit of the financial statements and that if the bank has an internal audit function, the internal audit will audit all significant and risky processes. Notwithstanding this recommendation still stands.

66. **Banks are not required to incorporate provisions related to dual control (four eyes principle) and provisions on the protection of assets.** The 2014 FSAP recommended that as part of their internal control frameworks banks should be obliged to include provisions related to dual control (four eyes principle) and provisions for the protection or safeguarding of physical and automation assets. It was recommended that the DFSA incorporate this into a revision of the EO-MC.

67. **As part of its ordinary inspections the DFSA meets with external auditors.** The purpose of the meeting as identified by the DFSA is to get the auditor’s view and assessment of the risks in the company; the management; the company’s current status/condition; as well as an assessment of
the company’s capital. The meeting also takes place to allow the DFSA to assess the external auditors’ quality and compliance with the rules.

**Comment**

68. **The numbers of certified auditors has been declining since the auditor certification regime was introduced in 2014.** Industry advises that the specific combination of qualifying requirements doesn’t typically align with how audit firms organize their resources. Auditors that take career breaks or seek a more diverse range of audit clients, even within financial services, may find challenges in meeting the requirements. In response to industry feedback the DFSA has already slightly relaxed the requirements but they are still considered challenging by industry.

69. **Stakeholder feedback indicates that the auditor meetings could be more effective.** The supervisory business process describing the auditor meetings confirms industry feedback that these meetings have often been considered to be very one-way with the supervisor expecting the information flow to be from the auditor only. The EBA *Guidelines on communication between competent authorities and auditors*\(^{13}\) confirms that the communication should be open and constructive, as well as adaptable to unexpected future developments. Competent authorities should share information with auditors on issues which are relevant to the statutory audit of the credit institution. It should be noted that any information shared during the communication between competent authorities and auditors is subject to the confidentiality requirements laid down in the CRD.\(^{14}\)

**Recommendations**

- Consistent with the recommendation from the 2014 FSAP, the DFSA should have access to the external audit papers of the banks under its supervision.

- The DFSA should ensure that its external auditor certification regime is appropriately balanced to ensure standards are maintained but competition, diversity and choice are available to banks. In the absence of some revision, the current certification requirements for bank external auditors may over time create a precarious shortage of qualified professionals. Banks currently have a choice of four audit firms which with mandatory rotation may be considered a narrow choice. If the current requirements are retained, there may ultimately be an unhealthy lack of availability, competition and diversity in the external audit market for banks.

- The DFSA should ensure that in bilateral meetings with external auditors, communication is open and constructive. Whilst ostensibly the meeting may be to focus on the auditors assessment of the entity and its risks, to be as useful as possible the DFSA should also share information with

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\(^{14}\) Section II of Chapter 1 in Title VII of Directive 2013/36/EU.
the auditor which is relevant to their function. A two-way conversation and information exchange would make these meetings as effective as possible.

- The DFSA should ensure an explicit reference to the need for dual control of assets in the EO so that banks are clearly required to include provisions related to dual control (four eyes principle) and provisions on the protection of assets.

- Audit and risk management reports of non-SIFIs should automatically be received by the DFSA when they are completed.

**AML/CFT**

70. **The DFSA is responsible for the AML/CFT supervision of all financial companies.** Approximately 1,800 financial companies are currently subject to the supervision of the DFSA’s AML Division, including banks, money remitters, insurance brokers, and pension funds. The DFSA’s powers and responsibilities for AML/CFT supervision derive, originally, from the Act on Measures to Prevent Money Laundering and Financing of Terrorism (Section 34(1), Act No. 442 of 11 May 2007). The DFSA’s AML/CFT-related powers and responsibilities were subsequently expanded via Act No. 651 (2017) and Act No. 1563 (2019), which were in part adopted to transpose, respectively, the EU’s 4th and 5th AML Directives.

71. **Subsequent to the last FSAP, the high-profile ML case concerning Denmark’s most significant bank** has brought attention to legislative and supervisory adequacy. The purpose of this TN is not to investigate the circumstances of that case or comment on whether the DFSA’s supervisory approach was appropriate, but to consider current practices and reforms that are now being brought forward in the specific context of banking supervision.

72. **A law that came into force in January 2020 heightened standards for firms and broadened the scope of the DFSA’s powers of remedial action.** Act No. 1563 (2019) tightens the responsibilities of financial companies. Similarly, protection of whistleblowers across the financial sector is strengthened. In addition, there is a requirement for banks, e-banks and payment institutions to have written policies, which ensure and promote a healthy corporate culture. With respect to corrective and remedial action in the field of AML/CFT, the DFSA’s powers of intervention and enforcement have been amplified so as to enable the DFSA to appoint and place one or more monitors within an FI, ban an FI’s acceptance of new customers (until specific breaches are rectified), and issue administrative fine (i.e., “fixed-penalty”) notices in respect of violation of AML/CFT obligations. A more extensive list of the reforms ushered in by Act No. 1563 (2019) may be found in Box 2 of the Fund’s 2020 Selected Issues Paper (SIP) *Next Steps for Cross-Border AML/CFT Supervision*.

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73. The DFSA is active in international and domestic bodies working to advance AML/CFT cooperation. The DFSA participates in relevant EU and Financial Action Task Force (FATF) meetings, both on the political level and the operational level. More specifically, the DFSA leads the Danish delegation to the FATF, and participates in the European Commission Expert Group on Money Laundering and Terrorist Financing as well as the Anti-Money Laundering Committee of the European Banking Authority (EBA).

74. In terms of cross-border supervisory scope, the DFSA has responsibility for financial firms incorporated, and foreign branches (EU and non-EU) that are established, in Denmark. Unlike the provision of financial services which can benefit from the EU passport for freedom of access to the EU Member States, AML/CFT supervision operates closest to the physical entity. Of course, the supervisor of the parent of any financial group that has establishments in other EU (and non-EU) jurisdictions is responsible for the supervision of the group as a whole. The distribution of responsibilities under the EU legislation places a primacy on effective cross border relationships and the timely and meaningful exchange of information. At the time of the mission, there appeared to be no impediments to the legal gateways that are needed to facilitate these intra-EU relationships. Supervisory colleges are active for cross-border banks, where it was clear information had been shared and discussed, and a Nordic-Baltic working group separate from the colleges has also been established.

75. Domestically, there are two significant coordinating bodies, one for the authorities only and one to engage with the private sector. The Danish Money Laundering Forum (MLF), which was formally established by Act No. 651 (2017) (Section 74), supports collaboration among the authorities. Participation in the quarterly meetings chaired by the DFSA comprises: the Financial Intelligence Unit (FIU), the Ministry of Taxation, the Ministry of Justice, the Ministry of Industry, Business and Financial Affairs, the Ministry of Foreign Affairs, the Gambling Association, The Danish Bar and Law Society, the Tax Authorities, and the Danish Business Authority. There are obligations on the participating authorities to cooperate and coordinate and a Memoranda of Understanding (MoU) elaborates the arrangements. The Money Laundering Forum Plus (MLF+) has been established under the auspices of the MLF to facilitate private stakeholders’ collaboration and two-way communication with the authorities.

76. The DFSA has acquired substantial new resources over the last several years and has significantly strengthened its business processes. At the time of the 2017 FATF Mutual Evaluation, the DFSA had only 3 to 4 persons working on AML/CFT. As of January 2020, there are 20 staff working on AML/CFT, measured in full time equivalents. The team has a diversity of skills, with backgrounds in tax, law, international banking, the public prosecution service, and the FIU. This staffing increase has, among other things, enabled the DFSA to conduct a major development project with the assistance of external, international consultants.\(^\text{17}\) Three outputs were delivered from the project: an inspection manual; a risk assessment scoring model; and a revised risk-based approach on which to organize AML/CFT supervision. The DFSA is currently working to refine the risk assessment scoring model and

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\(^{17}\) PA Consulting.
will fully integrate the final product into the work of the AML/CFT Division. As the DFSA now moves to the implementation stage, it should: (i) make all efforts to ensure that it “owns” whatever model and manual it puts into practice, making ongoing updates as necessary; and (ii) ensure maximum, systematic, internal coordination such that all information that is, or could be, relevant for AML/CFT oversight is captured, including information obtained via the DFSA’s prudential supervision, including qualitative information on governance, risk culture, risk management and systems and controls.

77. **The DFSA should intensify the on-site inspections of higher-risk FIs while continuing to expand onsite examinations to a greater number of banks.** The DFSA readily, and correctly, acknowledges that on-site inspections are a main pillar in AML supervision and that, because of their nature, banks are associated with a high inherent risk. Critical supervisory issues that the DFSA must rely upon cannot be fully ascertained through off-site processes. In other words, a full picture of a company and its governance, organization, risk profile, risk management and internal controls depends upon onsite practices, including extensive interviews at all levels of the institution as well as demonstration and testing of the systems used for e.g., transactions, monitoring and internal controls. While acknowledging that the DFSA considers time devoted to an onsite inspection to be considerably in excess of time spent onsite\(^\text{18}\), there is a limit to the insights offered by documentation and a continuing need to ensure that documentation in fact represents the reality of the bank’s operations. In this context, the intensification of on-site inspections of higher risk FIs should be pursued in parallel with – rather than to the detriment of – a continued expansion of the number of inspections conducted. If the DFSA is unable to inspect substantially more than 2 percent of the total population of companies in a given year, it would remain locked, perforce, into a 20-year or longer cycle to review the entire system, even allowing for annual targeted visits to DSIFIs.

78. **The DFSA has scope to improve internal communication and coordination.** Staff in the AML division and the banking departments alike have made efforts to ensure raised awareness of the necessity for information flow and of the type of information that is relevant. The strong collegiate approach in the DFSA furthers this task, as does the willingness of non-AML/CFT-focused supervisory divisions to support AML/CFT onsite examinations, but more consistent underpinning is essential to ensure that information is shared in a timely manner and red flags—which may be subtle at first—are not missed. It is important that the plans to enhance AML/CFT information sharing within the DFSA, noted above, are well designed and put into effect in the near future. As in other areas of supervision, attention needs to be paid to issues of governance, control and compliance. Patterns of behavior emerging or evident in institutions that can be identified from the remedial actions undertaken by the main supervisory divisions will also be likely to have relevance and on occasion active coordination between the AML division and the supervisory divisions will be necessary. It is also an area where compliance failings may be indicative of deeper concerns. One such example would be whether or not all institutions have the, legally required, position of Anti Money Laundering Officer (AMLO) filled: the DFSA could issue a useful signal to the industry by checking that no bank has a current AMLO gap.

\(^{18}\) An “inspection” might take 300 hours, for example, less than 20 of which might be spent onsite.
Operational Risk and IT Risk

79. **Operational risk is frequently associated with weaknesses in the AML/CFT control environment and is gaining increased supervisory attention.** At the last FSAP, the DFSA was rated materially non-compliant in the BCP assessment of the supervision of operational risk. Reforms since the last assessment have included both regulatory and supervisory developments.

80. **Regulatory enhancements provide more clarity to banks on supervisory expectation.** The DFSA has expanded the national regulation on the operational risk area to include more detailed requirements with respect to the banks’ operational risk policy, guidelines and processes in the executive order of management and control of banks etc (Annex 3). Furthermore, the DFSA has introduced a notification requirement on significant operational risk events.

81. **Supervisory changes include development of procedures for off-site monitoring of trends in operational risks and changes in the banks’ individual risk profiles.** The summaries of operational risk profile on a bank by bank basis are detailed, though, as yet, it is not straightforward for a supervisor to compare assessments across banks. Additional reporting requirements were introduced in 2016 for medium and large banks based on the basic indicator approach and is similar to the reporting required for banks on the standardized approach. As a result, the DFSA has been obtaining annual data on the number and scale of loss events, as well as loss event registration thresholds for all loss events over the previous year. The DFSA indicated that much of the operational risk assessment depends on onsite inspections, although supervisors clearly include operational risk in the annual risk assessment and in the context of on-going supervision. For the SIFIs, inspection is carried out by the supervisory division responsible for SIFIs, but other than this, the policy expertise for operational risk is embedded in a different banking division. For SIFIs, the operational risk assessments will take place in functional or SIFI-wide thematic inspections (the last one was 2015) but operational risk is discussed at least annually with senior management and the DFSA meets with the head of operational risk in the SIFIs once or twice a year. Enhancements to the operational risk regime are valuable, and the DFSA is encouraged to maintain momentum, for example, including assurance that SIFIs risk practices are fully understood and up to date and that the relevant SIFI divisions are fully aligned with the policy center on operational risk.

82. **IT supervision has been a particular focus of attention, with the DFSA Board approving a plan, in early 2019, to strengthen IT supervision further.** The plan includes a more rigorous methodology for risk assessment and classification of financial institutions, strengthening the methodology for IT supervision in SIFIs and developing a methodology and framework for IT supervision for non-SIFIs. Notwithstanding the revised plan, the IT risk team’s resources appear lean given the scale of the risks and the number of entities to supervise. In order to provide support and insight in particular to the non-SIFI banks, the DFSA should consider leveraging external expertise to support its onsite work in this area.

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19 No Danish bank has ever applied for approval to use Advanced Modelling Approaches (AMA) for operational risk capital adequacy.
Liquidity and Covered Bonds

83. **With the exception of Danske, liquidity is assessed at both solo and group level in the Danish banking system.** As Danske is a conglomerate (bank, pension and mortgage credit institution), the DFSA assesses liquidity and funding risks at a “wider group” level. Since the last FSAP, the Liquidity Coverage Ratio has come into force and banks are required to meet a range of standards and guidelines. Please see Appendix 2 for details of the metrics currently in force.

84. **The DFSA has a dedicated division that is responsible for liquidity supervision of SIFIs and is a center of policy excellence for other banks.** The dedicated division—International Market Contact, Liquidity and Capital (ILKA)—is responsible for policy as well the onsite inspections of SIFIs for liquidity and capital. Thematic inspections carried out by ILKA have included assets used in the liquidity buffer, structure and assumptions of stress tests and run off rates. Current topics to focus on include categorization of inflows. Future topics might be stress testing within the smaller bank sector, though within this sector, options for contingency plans are highly limited.

85. **The DFSA seeks to benchmarks credit institutions against peer institutions, but a systemic overview may be missing.** For example, the DFSA requires banks to prepare contingency plans and these are assessed by the supervisors responsible for the entity. However, the DFSA has not prepared any analysis considering scenarios where sectors (or all) of the banking system would need to utilize their contingency plans at the same time, in order to identify potential additional pressures due to individually planned strategies that could not be achieved if multiple institutions were attempting to act in the same way at the same time.

86. **The use of covered bonds is a notable feature of the Danish market and important in banks’ liquidity management.** While it is clear that Danish banks have been meeting the LCR, even in times of stress, as a general principle it is of course important for prudential oversight of the LCR to consider the risks of both asset concentration and overreliance on market liquidity.

**Recommendations**

- The DFSA should execute a system wide analysis of contingency plans to ensure feasibility in the case of a systemwide, rather than idiosyncratic event affecting liquidity in firms. This is particularly relevant in Denmark given the comparatively high reliance on covered bonds to meet the LCR.
Box 2. Denmark: Use of Covered Bonds by Danish Banks for Liquidity Risk

The Danish market for covered bonds is one of the largest in the world and plays a key role in Danish funding markets. As an important national specificity and having performed well in the global crisis, the EU design of the Liquidity Coverage Ratio (LCR) is more generous towards covered bonds than the Basel standard. This discrepancy was considered a material deviation when the EU framework was assessed for completeness and accuracy against the Basel standards by the Basel Regulatory Consistency Assessment Programme (RCAP).

Danish banks rely significantly more heavily on covered bonds to meet LCR requirements than banks in any other EU member state. Based on EBA monitoring⁴ (see also chart below) covered bonds comprised nearly half (48 percent) of the total liquidity buffer at end-2018⁵, and is almost double the percentage of the EU country with the next highest composition of covered bonds (Finland at 26 percent).

The nature of the market presents challenges for liquidity management. Under EU regulation³ covered bonds that meet certain tests qualify as High Quality Liquid Assets (HQLA) Level 1. Although not all covered bonds in the EU are recognized as HQLA Level 1, eligible bonds can meet up to a limit of 70 percent of the HQLA. In Basel covered bonds are deemed HQLA Level 2B only and Level 1 HQLA are reserved primarily for central bank reserves and sovereign exposures. Should the EU covered bond deteriorate, it may lose its eligibility under the LCR, and the bank must de-recognize it as a liquid asset within 30 days, leading to a potential liquidity pressure. Given the highly interconnected nature of the Danish markets, the liquidity pressures may not remain idiosyncratic but be communicated through the system.

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¹ https://eba.europa.eu/sites/default/documents/files/EBA%20Report%20on%20Liquidity%20Measures%20under%20Article%20509%20%281%29%20of%20the%20CRR.pdf


³ Delegated Regulation (EU) no 2015/61 Article 10, 15, 16 and recitals (6) and (8).
E. Use of Supervisory Powers in a Changing Environment

Corrective Actions and Enforcement

87. The DFSA places great emphasis on an orderly and disciplined financial sector and actively uses its options for corrective and remedial measures. In just under a five year period, the DFSA recorded over 2,000 supervisory measures taken against banks and mortgage credit institutions. The very great majority, over 80 percent, of these actions were Orders. Discussion with industry participants indicated that an Order from the DFSA is a serious event that commands the attention of the management, and, depending on the severity of the topic, of the Board of Directors. Firms confirmed that not only does an Order directed to their own firm receive close attention, but so do Orders that are issued to other banks. Given that Orders are public, banks have the opportunity to monitor their peers and identify issues that may be of current particular concern to the DFSA. At the smaller end of the market, the relevant trade association is active in monitoring for its members.

88. Based on interviews and records, it is clear that the DFSA monitors the progress of Orders but also that the DFSA needs to expend more effort in confirming the veracity of information received. Having received and Order, a bank must complete its remediation by a given date. In some, if not most instances, a bank can clear the Order by submitting documentation, for example a revised policy or process or an explanation of actions taken by the bank. One potential risk of this approach to ensuring that supervisory concerns had been resolved is that the firms do not supply full, complete or accurate information (or in an extreme worst case scenario fabricate documentary "evidence" for the DFSA). To mitigate this concern, industry participants pointed out that consciously providing misleading information to the DFSA in the course of responding to an Order would lead to severe escalation by the supervisors. In other words there is a clear disincentive to overstate achievements. Nevertheless, it was agreed both by industry and supervisors that there is a tradition of taking information on faith when it has been requested. This feature applies both to information flows within a firm and between the firm and the supervisor. The DFSA is strongly recommended to raise the bar in terms of when it is legitimate and reasonable to rely on information without independent scrutiny. It is not a concern that firms will have an intent to deceive, but they may have misunderstood the gravity and extent of the requirements they are expected to meet. Resource constraints are real, so prioritization is obviously important. However, on an overall basis, greater systematic scrutiny, challenge and verification of information is needed by the supervisor when receiving information from firms.

89. The DFSA keeps records of corrective and remedial actions and has important plans to exploit this database more effectively. A central log lists the corrective actions that have been launched, but it is not yet readily searchable to see if particular issues or patterns of issues can be identified, either within or across peer groups or sub-sectors of banks. However, as the DFSA is alert to the potential for horizontal/thematic work to yield broader lessons that can be communicated to banks, there are plans to optimize the potential for identifying lessons embedded in the pattern, frequency, severity and target of the Orders it has issued. This direction is valuable and can be expected to yield fruitful insights. In particular, the DFSA is encouraged to examine its findings and assess whether in some cases there are common root causes of deficiencies, for example, where a
number of orders have been issued to a single bank there may be a particular governance failing that links the different problems that have already been identified.

**Licensing**

90. In the context of the Government’s wish to promote Denmark as a FinTech hub and a relatively low capital barrier to entry, greater activity in licensing and change of control is already being seen. For this reason, the detailed approach taken by the DFSA, including the processes of investigation and scrutiny, as well as the balance of proof that an applicant must meet warrant consideration.

91. The DFSA, which is the competent authority to issue a banking authorization following a decision of the Board (FBA, section 14), is reasonably well equipped from a regulatory perspective. Importantly, the DFSA can withdraw an authorization due to failure to meet licensing requirements on a continuing basis, but may only withdraw a license given on the basis of false or misleading information if this was given deliberately and the information was crucial to the decision to grant a license. The Danish legislation addresses the relevant factors at a high level, including fit and proper requirements (including lack of criminal record), identification and suitability of key function holders, adequate procedures and administrative provisions, corporate governance, colocation of head-office and registered office and absence of conditions that would present an obstacle to supervision. However, for appointments to a systemically important financial institution (SIFI) or global systemically important financial institutions (G-SIFI), there are additional requirements surrounding remuneration, number of positions that can be held at the same time and adequacy of time to devote to the institution. (FBA sections 64 and 313 et seq).

92. Moreover, while EU standards are also relatively high level in the field of authorization there are moves to add specificity and further articulate expected standards. The Capital Requirements Directive (CRDV) has introduced more detailed requirements, so that a candidate must submit, a program of operation in more detail than before, including descriptions of arrangements, processes which will deliver robust governance arrangements\(^{21}\) (e.g. clear organizational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management.) Furthermore, the EBA has submitted (July 2017) its final draft texts to the European Commission as a basis for RTS and ITS to support the quality and consistency of supervisory decisions on licensing, the final RTS and ITS have yet to be issued.

93. In this regulatory context, the DFSA has been diligent in its processes and taken due time in its decision making. Over the last five years the DFSA has granted four licenses and

\(^{20}\) EUR 5 million is the threshold for absolute capital a credit institution must hold, in the form of common equity tier 1.

\(^{21}\) Directive 2013/36/EU, articles 10 and 74, as amended by Directive 2019/878/EU.
withdrawn thirteen. Loss of authorization has generally been due to the merger with or takeover of the institution by another financial institution. In some cases authorizations have been voluntarily surrendered due to general consolidation, or, in a few cases, due to financial difficulties. In one case the license has been revoked following the institution being declared likely to fail, not due to capital issues, but general violations of regulatory requirements.

94. **In view of increased market activity and EU legislative amendments, it is therefore very welcome that the DFSA is scheduling an update to its licensing manual.** It is recommended that, as a part of the revision to the manual, the DFSA requirements for more details to be logged in the formal recommendation note, that goes to the Director General to ensure that there is an unambiguous record that all key aspects that should be considered in an application for a banking license have been taken into account in the final decision. The recommendation note, by definition, will focus the attention and should include as standard, for example, issues relating to the planned future funding strategies, in particular, any planned reliance on deposits, future access to capital if it should be needed, how resolution will be organized in the event of failure to avoid loss to depositors or use of the deposit guarantee fund. A greater attention to the quality of key persons and governance and control factors should also be included in the recommendation note, and the overall decision-making process and analysis by the DFSA as needed. It is suggested that the DFSA conduct a final on-site inspection to confirm all systems, controls and key persons are in place, before operations commence.

95. **In terms of industry communication, the DFSA is recommended to be explicit on its expectation.** This means that requirements for authorization, or other permissions—such as change of control, fit and proper—must be fully and robustly before an authorization/decision can be granted or approved or even a recommendation for such a decision can be made. The burden of proof must rest on the applicant to demonstrate conditions have been satisfied to a suitable standard, rather than the DFSA having a concern that there is no positive evidence on which to withhold a permission or reject an application.

**Change of Control**

96. **Consolidation and mergers have followed in the wake of the financial crisis but prospective market entrants seeking to take over banks puts a premium on assessing potential change of control.** By definition, the principles under consideration at a change of control of an institution are broadly the same as for an initial authorization. The DFSA conforms to directive requirements in the EU, which in the field of mergers and acquisitions, include some factors, including the time taken to consider an application, which are subject to maximum harmonization and cannot be applied more stringently at national level.

97. **The FSAP repeats a previous recommendation that the DFSA be granted expanded powers in relation to significant (qualifying) ownership.** This recommendation seeks to ensure that the DFSA would be able to reverse a change of control that had not been assessed and approved when, by law, it should have been. In the DFSA view the FSAP recommendation is legally challenging to achieve and this power has not been accorded to the DFSA. Instead, the DFSA has the
power to revoke voting rights associated with shares if it has not approved a qualifying holding\textsuperscript{22} (which includes change of control). This power includes cases where an acquisition has taken place despite the DFSA having refused its approval. This is a power that the DFSA has exercised. For example, in one case where it was considered that a group of persons were acting in connection to take control of an institution, the voting rights were revoked for all participants.

98. \textbf{The ability to revoke voting rights is welcome but the recommendation to widen the DFSA’s ability to reverse a change of control where its approval was required still stands.} Although the revocation of voting rights is a powerful tool, the presence of controlling interests of whom the DFSA does not approve is undesirable to the stability of the institution and potentially leads to more significant issues for the DFSA to have to contend with in the future. Similarly, the previous FSAP recommended that the FBA be amended 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. While the EU legislation (CRDIV) may currently be silent on this aspect, the DFSA is again encouraged to enact this requirement.

99. \textbf{The DFSA exercises sound practice in requiring financial institutions to make an annual submission of their shareholding structure.} Firms must submit by February each year information to the DFSA of the names of the owners of the capital who own qualifying holdings in the financial institution as well as information on the sizes of said interests (FBA section 61c (2)). The DFSA is encouraged to undertake periodic exercises to confirm that new information that is relevant to the scope of consolidation, identify of new related parties or viability of the business strategy is taken into account in the ongoing supervision strategy.

\textbf{Fit and Proper Assessments}

100. \textbf{The DFSA has already made revisions to its fit and proper assessments and its recent refusal to approve a senior candidate for a CEO position has given a strong market signal.} Discussions with industry participants made it clear that there is a growing awareness that the DFSA’s expectations are rising. The DFSA scrutiny is welcome but the DFSA is recommended to undertake an even deeper assessment of candidates and to apply supervisory judgement and discernment, which at times, might suggest a different outcome from a straightforward review of academic qualifications or nature of c.v. Unlike some other authorities, the DFSA not only undertakes fit and proper assessment in cases of new authorization or change of control, but when an institution introduces new key persons. However, the DFSA does not have the authority to conduct fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies and it is recommended that the DFSA scope is expanded in view of the potential for the nature of the ownership in the banking sector to evolve.

\textsuperscript{22} FBA Section 62.
Related Parties and Scope of Consolidation

101. Identifying related parties is important in both licensing and change of control and Danish law benefits from better definitions than EU legislation. With respect to identifying related parties, the identification of ultimate beneficial owners is important for ongoing supervisory needs (including concentration risk and exposures, for example) as it is for AML/CFT oversight. It is therefore welcome that, as a consequence of the 5th Money Laundering Directive, amendments to the Danish rules on beneficial owners will enter into force in January 2020.

102. Relatedly, there have also been welcome changes to the definition of related parties, raising requirements for an individual associated with a SIFI. In general terms there are two sections of the FBA that govern related party issues. One aspect relates to individuals (sections 78, 80 and 313b) and the other relates to Intra-Group Transactions/Exposures (section 181-182). Building on its good foundation, the DFSA is encouraged to press for further development of the definitions. For example, key employees in small and medium sized banks (not systemic important banks) should be covered by the definition, as should persons related by marriage etc. to members of the board of directors. Inclusion of persons with a direct/indirect interest in the institution below 20 percent is recommended. Additionally, the definition should be widened/further specified to ensure that the DFSA’s and the bank’s own risk analysis is taking into account transactions and services, not just transactions that result in on or off-balance sheet exposures, that are undertaken for an institution by a related party. It is through this avenue that unexpected dependencies might emerge.

103. In terms of scope of consolidation there is more that the DFSA could do. At present the DFSA does not apply prudential rules more generally to financial holding companies given that the majority of financial holding companies in Denmark have no other significant activities besides owning shares in financial companies. Similarly, the DFSA has no authority to conduct fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies as discussed above. From a resource perspective, these two issues, which were both subject of recommendations in the last FSAP, may appear to be a logical outcome. From the perspective of identifying future possible risks, or risk indicators, at an early juncture, and in view of the potential for the landscape of credit institutions to be subject to new entrants and new controllers, the recommendations stand.

Recommendations

- The DFSA must become more systematic in explicitly confirming the veracity of information received in the course of its supervisory work.

- The DFSA must exploit its database of corrective and remedial actions effectively to ensure that common issues or emerging patterns are identified in firms.

- The DFSA must review its database of corrective and remedial actions to ensure that root causes of issues are not being missed and time is not being spent only on addressing issues that are symptoms of deeper concerns.
DENMARK

- The DFSA should be granted the ability to reverse a change of control where its approval was required but was not obtained.

- The DFSA must be granted the authority, amending the FBA as needed, to broaden definition of related party (in laws or in DFSA Guidance) to ensure that transactions with related parties includes:
  - Key employees in small and medium sized banks (not systemic important banks);
  - Persons related by marriage etc. to members of the board of directors;
  - Persons with a direct/indirect interest in the institution below 20 percent;
  - Transactions and services, not just transactions that result in on or off-balance sheet exposures, that are undertaken for an institution by a related party.

- The DFSA should have the authority to apply prudential rules more generally to financial holding companies.

- The DFSA should have the authority to conduct fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies.
Appendix I. DFSA Powers of Corrective and Remedial Actions

1. The DFSA’s powers are based on the FBA which provide the authority with a graduated suite of corrective actions and disciplinary measures culminating in early intervention measures or revocation. In order to insure that banks and financial holding companies act in accordance with the financial regulations the DFSA has the following powers and instruments:

- **Service information** – feedback to a bank in relation to deficiencies that do not pose a risk to the bank’s business.

- **Risk information** – to direct a bank’s attention towards increases in risk or specific unsustainable elements in the bank’s business model. It is not applied in cases of breach of law or regulation and typically arises as a result of onsite inspection. Risk information can be issued to several banks at the same time in respect of themes and tendencies identified in horizontal, thematic reviews.

- **Orders and prompt enhancements** – where there has been a breach of law or regulation, an Order is imposed. Orders to make prompt enhancements are only applicable towards insignificant breaches of law, such as disregard of formalities. An order constitutes a decision and must articulate thorough reasoning and include guidelines for appeal. The general legal basis for the DFSA to impose orders is a result of the FSA’s broad supervisory authority\(^1\) as well as specific provisions to issue orders e.g. FBA Section 350.

- **Reprimands** – A reprimand is applied retrospectively, in cases where there has been a breach that has been rectified by the bank. As with Orders, a reprimand is publicly disclosed. It is only applied if there is an insufficient basis to report the breach of law to the police.

- **Penalty fines** – the DFSA may apply daily fines to incentivize swift remedial action either through the FBA, section 374 (“undertaking fail 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”) or the Anti-Money Laundering Act, section 80(1). Such fines may be on a daily or weekly basis and can be imposed upon the board of directors, board of management, external auditor, chief internal auditor, responsible actuary, liquidator, general agent, branch manager or board of representatives of a financial undertaking.

- **Fixed penalty notices** – The FBA, section 373a\(^2\), grants the DFSA authority to issue fixed penalty notices without a court ruling provided that the bank pleads guilty and agrees to pay the fine. Fixed penalty notices are not necessarily final, and they can be subject to the court’s further consideration and ruling.

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\(^{1}\) FBA Section 344(1), Anti-Money Laundering Act Section 47(1), etc.

\(^{2}\) The power is implemented by Executive Order no. 186 as of March 8th, 2011.
• **Police reports** - The DFSA can report an individual or a bank to the police (The State Prosecutor for Serious Economic and International Crime) in the event of more severe breaches of law. A police report is filed in cases where there is sufficient legal and substantial grounds for further criminal prosecution. A filing can only be made with the approval of the DFSA’s Supervisory Board (FBA Section 345(7)). The filing is publicly disclosed and can be given simultaneously with an order to stop the breaches of law. A recent high profile case has been the September 2019 filing in respect of Danske Bank due to misleading information provided to its customers.

• **Revocation/withdrawal of license** – Subject to the approval of the Supervisory Board, the DFSA has the authority to withdraw an authorization to exercise banking operations under certain conditions (FBA sections 223-225, section 350 and 351), of the FBA. The DFSA can, for example, revoke an authorization:
  - For serious or repeated breaches of law including the Danish Financial legislation and EU law
  - Failure to continue to meet authorization criteria and requirements
  - Failure to meet capital requirements
  - If the bank is failing or likely to fail

2. **There are a range of circumstances that permit the DFSA to intervene or take action even if the bank meets minimum regulatory requirements.** A very specific tool is the DFSA Supervisory Diamond which contains a number of criteria that are conservatively calibrated—should a bank breach these limits, the DFSA has the power to act. The Supervisory Diamond thus acts as a form of early warning. Furthermore, should the DFSA have concerns regarding the financial situation of a specific bank, even where the bank still meets its regulatory requirements, the DFSA may, order the management of a bank to prepare an account of the financial circumstances and future prospects of the bank (FBA section 349 (1)). Where such an order is issued, the Board of Directors, the Board of Management, the external auditor and the chief internal auditor of the bank are required to sign the order, ensuring a comprehensive awareness of the DFSA concerns. The DFSA can issue orders for remedial measures to be completed within a specified time period if there are concerns that the depositors’ interests are at risk or there is a significant risk of the deterioration of the bank’s financial condition (FBA section 350 (1) and (2)). Ultimately, if measures are not met within the time limit the DFSA can revoke the authorization.

3. **The DFSA also has enforcement options based on supervisory judgment that risk governance and controls are inadequate or when the bank is engaging in unsafe or unsound practices.** Should a Board of Directors fail to meet the FBA requirements to establish good governance, risk management policies, processes and control systems in the bank (FBA Section 70(1) and (2)) they are liable to fines from the DFSA (FBA section 373 (2)).

4. **Furthermore, the DFSA has powers available in the event of concerns and deficiencies with respect to the management, directors and shareholders of a bank.** Under the FBA (section
351) the DFSA may compel the bank to remove a senior manager if the senior manager is no longer fit and proper. The DFSA can also ask a member of the board to quit if the board if the member no longer fulfills the fit & proper requirements. The DFSA can withdraw the license of the bank if the bank does not remove the member of management or if a member of BoD fails to comply with an order before expiry of the time limit that is set. Further, as indicated above, the DFSA may order one or more members of the BoD or the BoM to resign, if the bank’s financial situation deteriorates substantially or if there are one or more serious breaches of financial legislation (FBA section 243b). With respect to controlling shareholders, the DFSA has powers (FBA section 62(1) and (2)) to order a bank or holding company to follow specific guidelines and withdraw the voting rights associated with the equity investment, if the owner fails to meet the fit & proper requirements (FBA section 61a (1)) or fails to submit a prior application for approval before acquisition of the equity. The mission discussed examples of when this power had been exercised.

5. **Activities and organization of the bank can be subject to intervention by the DFSA.** Should the DFSA find that a bank does not have effective forms of corporate management, including a clear organizational structure (FBA section 71(1)) the bank can be ordered to change its organizational structure. The DFSA also has powers (FBA section 179) to order a parent to separate subsidiaries into a subgroup, if the company structure prevents the parent company from meeting solvency standards, if a member of the Board of Directors or Board of Management of the parent company is not fit and proper or that the company structure makes it difficult for the DFSA to carry out its supervision. Also, as noted below, the DFSA has powers to amend a bank’s organization in the context of early intervention (FBA section 243a). Relatedly, the DFSA has power (FBA section 350(1)) to restrict a bank’s activities.

6. **In the event of distress or emerging distress and possible failure of a bank, the DFSA has powers of early intervention.** In such cases, under the FBA (section 243a) the DFSA may require the bank to:
   - Activate its recovery plan, or require an update of the recovery plan (required under FBA sections 71a and 71b);
   - Prepare and submit an action plan to the DFSA;
   - Convene a general meeting of its shareholders;
   - Require a member(s) of the board of directors or management to resign their position;
   - Prepare and submit a plan for negotiations regarding restructuring the undertaking’s debt;
   - Change its business strategy;
   - Change its legal or operational structure; and
   - Contact potential buyers in order to prepare for the winding up of the undertaking.
Appendix II. Summary of Quantitative Liquidity Requirements in Denmark

1. **In terms of liquidity metrics, the DFSA supplements the EU requirements with additional instruments.** The EU metrics – transposing the international Basel requirements are the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). The LCR is now fully in force and the NFSR will apply from June 2021. The expected impact of the NFSR is not expected to be significant as most Danish banks have large deposit surpluses. The Danish mortgage credit institutions are also expected to comply with the liquidity requirements. The additional Danish liquidity tools are embedded in the Supervisory Diamond: a funding ratio benchmark and a (new) liquidity indicator.

   - The funding ratio indicates the ratio between lending – funding need – and the stable funding in the form of working capital subtracted bonds with a residual maturity of less than one year. The value should be below 1.

   - As of June 2018, a new liquidity indicator (liquidity requirement ratio) came into force for all Danish banks. Banks are expected to hold a sufficient liquidity buffer to cover a three months liquidity stress scenario based on the liquidity stress assumptions from the LCR. Thus, in the first month of the stress scenario the assumed stressed inflows and outflows from the LCR are applied and in order to reduce complexity, only the main outflow and inflow elements from LCR are applied, such as maturing issuances and term deposits. The liquidity stress scenario shall be covered by a liquidity buffer as defined in the LCR, but with two modifications; 1) the cap on asset classes does not apply and, 2) the definition of liquid assets is extended and includes own issued covered bonds and covered bonds with issue size smaller than EUR 250m. The modifications are made in order to account for the very large, liquid and high quality covered bond market in Denmark and to simplify the calculation. The value must be above 100 percent.

2. **The intended effect of the EU/Basel and supplementary liquidity metrics is to have oversight over the various maturity periods of liquidity:**

   - Short-term liquidity risks are managed through the regulation in LCR as well as the liquidity indicator in the supervisory diamond (liquidity requirement ratio).

   - Medium-term risks are managed through the liquidity indicator in the supervisory diamond

   - Long-term liquidity risks are currently managed through the funding ratio in the supervisory diamond and will also be managed through the NSFR when implemented in 2021.