Credit institutions

# Market development 2020

# Contents

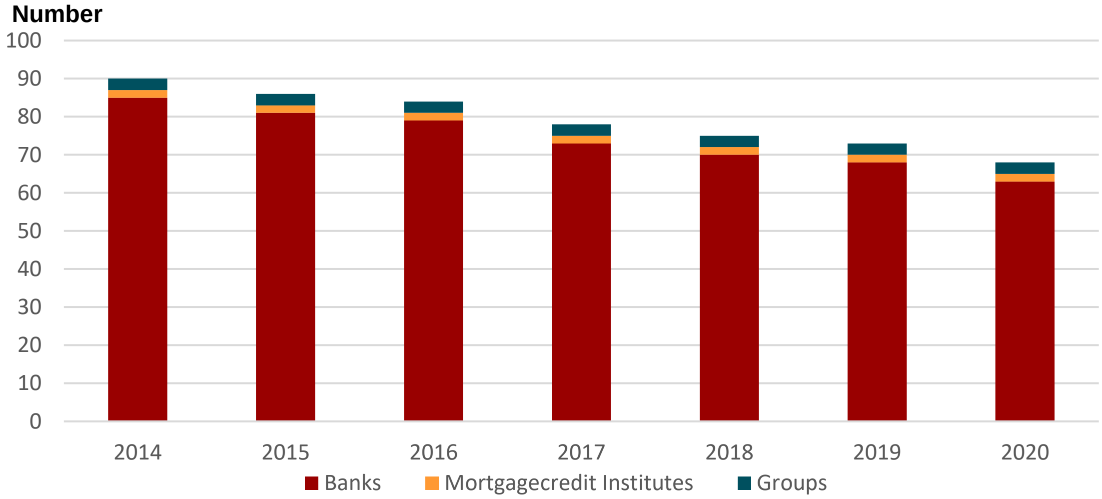
## 1. Summary

For the Danish credit institutions, as well as for the rest of society, the year 2020 was impacted by the global COVID-19 crisis. The Danish credit institutions entered the crisis well-capitalised, and generally had a good starting point for being able to supply credit and liquidity to both companies and households. However, government assistance packages have generally resulted in limited credit demand, and there has been only moderate growth in loans issued by credit institutions in 2020.

Based on a strong capital position, the Danish credit institutions have so far performed well during the crisis and their capital position has, despite the COVID-19 crisis, been strengthened in 2020, e.g. given a limited capital distribution. The credit institutions are therefore in a robust position to be able to absorb the losses that are expected to materialise in the wake of the crisis.

The COVID-19 crisis has led to a severe economic downturn. The recent resurgence of the pandemic in Europe increases the uncertainty about the future, the economic outlook and may delay the time of the expected recovery. All other things being equal, it must be expected to lead to increased impairments in the credit institutions. The economies are supported by a wide range of fiscal and monetary policy measures that have been implemented since the outbreak of the COVID-19 crisis. Rolling back these measures will result in increased losses for the credit institutions. These losses should to a large extent already be covered by expensed impairments.

**Figure 1: Number of credit institutions in Denmark**




Note: Groups are defined in this context af firms which include both mortagecredit- and banking business.
Source: The Danish Financial Supervisory Authority's register on financial firms

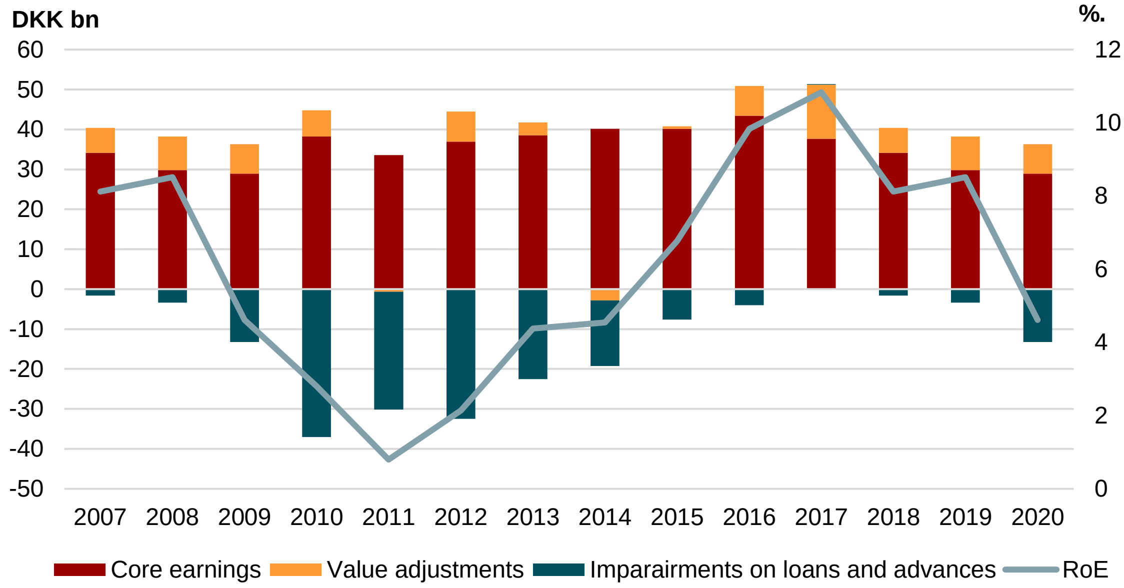
For many years, there has been a tendency for greater consolidation in the credit institution sector, cf. figure 1. This trend continued into 2020 with a final number of 68 credit institutions[1] . That is five less than the year before. This consolidation must be seen in the context of the sector's challenged earnings potential and the need to reduce costs through economies of scale.

[1] Adjusted for credit institutions that are subsidiaries of other credit institutions.

## 2. Earnings

The Danish credit institutions had a total profit after tax of DKK 19.6 bn in 2020. That is 35 percent lower than in 2019. Increasing impairments on loans as a result of the deteriorating financial situation and increasing costs explain the negative development overall. The credit institutions wrote down a total of DKK 13.2 bn in 2020, and core earnings decreased by 3 percent, cf. figure 2. Since 2016, core earnings in the Danish credit institutions have decreased by 33 percent.

**Figure 2: The components of credit institutions' performance**



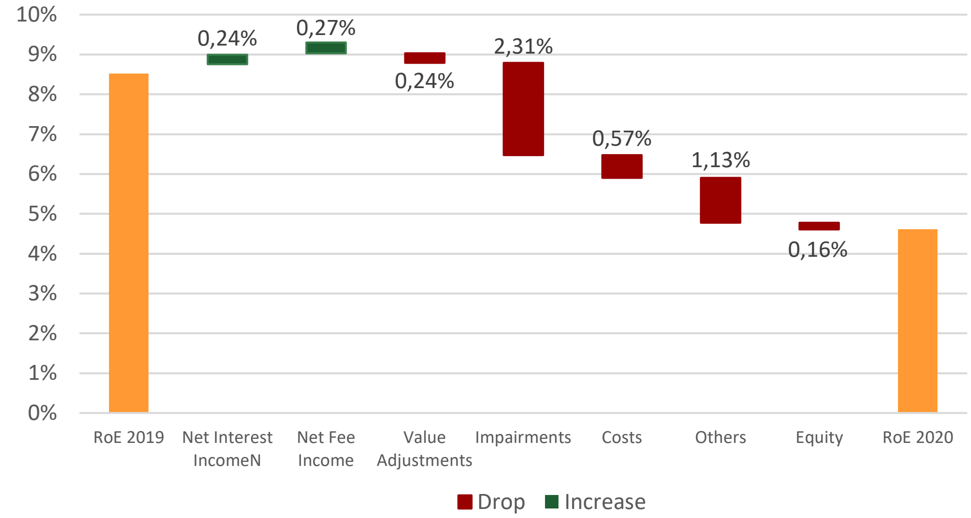

Note: Core earnings consist of net interest and fee income, personnel and administrative expenses, and other operating income and expenses. This is an expression of the credit institutions' core business. Note the transition to IFRS9 in early 2018, which may have meant higher impairments.
Source: Reports to the Danish Financial Supervisory Authority

Exchange rate adjustments also contributed positively to the result for 2020, despite the significant market turmoil in March, when the COVID-19 crisis broke out.

Impairments for the year increased from DKK 3.4 bn in 2019 to DKK 13.2 bn, corresponding to an increase of 289 percent. However, it is still far from being on a par with the impairments during the financial crisis (2009-10) and during the European sovereign debt crisis (2010-12). In addition, impairments have been very low over the past five years.

The return on equity, which measures the return which the credit institutions' owners receive in relation to their invested (accounting) capital, decreased from 8.5 percent in 2019 to 4.6 percent in 2020 due to the poorer result and increased equity. The decrease was largely driven by higher impairments on loans and guarantees as well as increasing costs, cf. figure 3. However, credit institutions increased both their net interest and net fee income despite the low interest rate environment. This was due to declining interest costs, due to increased use of negative deposit rates, and increased fee income.

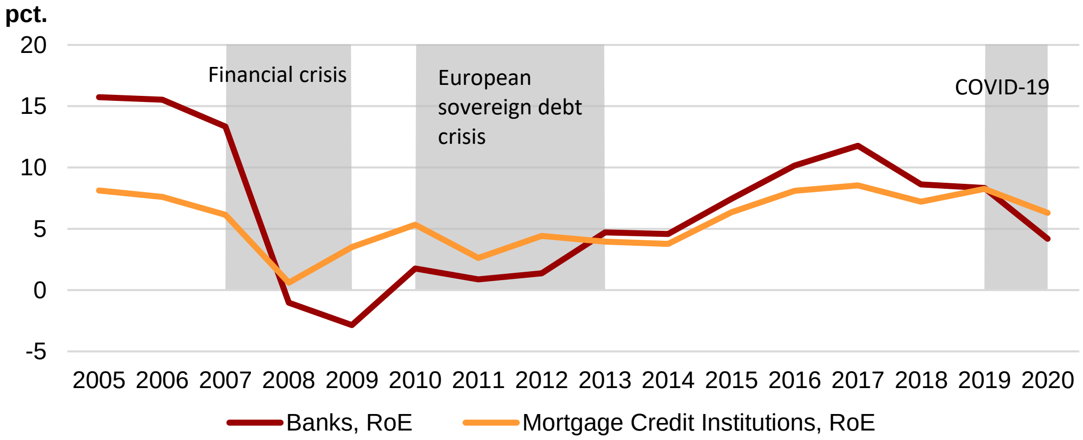
**Figure 3: Return on equity and driving forved for changes in the equity business**




Note: The category others include: i) taxes (-0,55%), ii) result of investments in associated firms (-0,43%) and iii) dividend on shares (-0,15%).
Source: Reports to the Danish Financial Authority

Mortgage credit institutions are less affected by the economic downturn during the COVID-19 crisis than other banks measured by impairments. In a historical perspective, this is to be expected, as mortgage credit institutions in a recession have typically been less affected by credit losses than other banks. This is mainly due to the mortgage credit institutions' business model, where mortgage loans have a higher priority than bank loans in the total mortgage, and the mortgage credit institutions thus has greater security. The current economic downturn has also not been reflected in house prices, which on the contrary have increased. This helps to explain the smaller impairments in the mortgage credit institutions.

**Figure 4: Return on equity after tax**



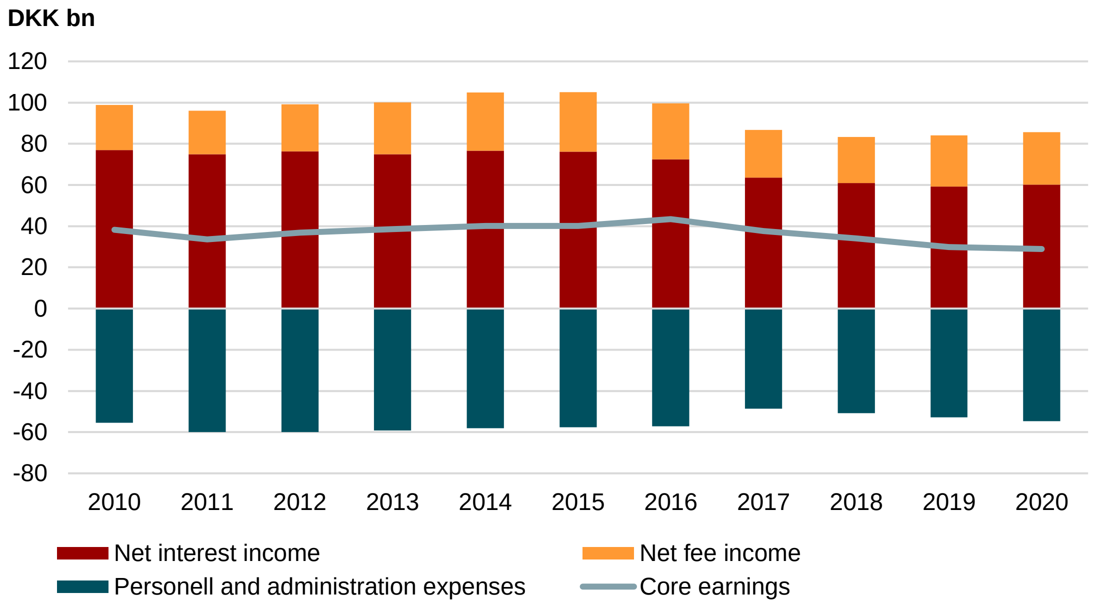

Sorce: Reports to the Danish Financial Supervisory Authority

Mortgage credit institutions are also not affected by the low interest rate environment in the same way as other banks. This is because the core earnings of the mortgage credit institutions can mainly be traced back to the contribution rates, which serve as an interest margin for the mortgage credit institutions that is not directly affected by the interest rate level. However, there may be a derivative effect from the borrowers' choice of loan. Therefore, the development in the mortgage credit institutions' return on equity is significantly more even than that of the other banks, cf. figure 4.

Banks, on the other hand, generate a significant part of their interest margin and net interest rates through the difference between lending rates and deposit rates. Despite negative market interest rates, banks alone have more gradually chosen to subject private customers to similar negative interest rates on their deposit accounts. Over the past few years, however, most banks have introduced negative interest rates on private customers' deposits above a certain threshold. Throughout 2020, there has been a tendency for banks to have reduced this threshold value, so that for some banks today it is DKK 250,000, while several banks have gone all the way down to DKK 100,000.

The introduction of negative interest rates for both corporate customers and most recently several private customers has contributed to the credit institutions' core earnings stabilising, partly driven by a small increase in the banks' net interest income, cf. figure 5.

**Figure 5: Credit institutions' core earning components**

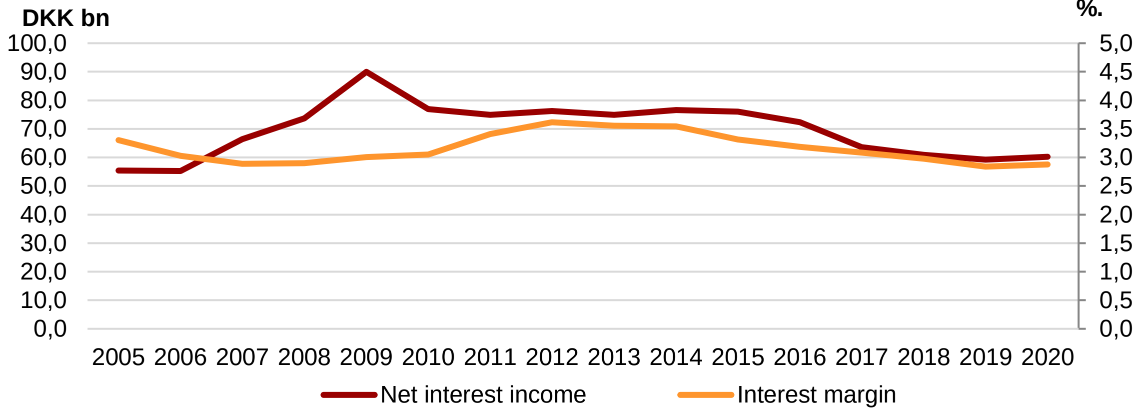



Source: Reports to the Danish Financial Supervisory Authority

*Net interest rates, interest margins and volume effects*

Since 2014, credit institutions' net interest income has followed a declining trend. Overall, net interest income decreased by 21 percent from 2014 to 2020, cf. figure 6. The development in net interest income can be attributed to changes in both price (interest margin), volume (lending growth) and the composition of lending and the capitalised assets, cf. figure 7. During the same period, the credit institutions' interest margin decreased by 0.4 percentage points.

**Figure 6: The credit institutions' net interest rates and interest margin**

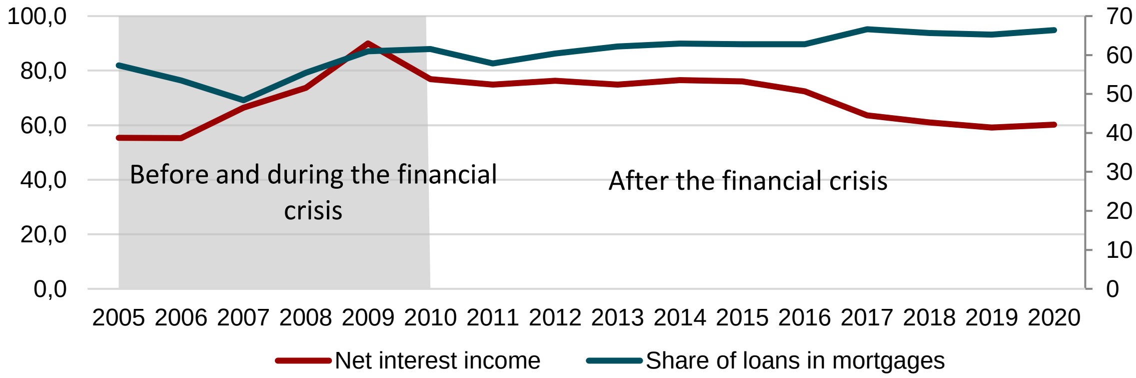



Note: The interest margin is calculated for outstanding businesses and limited to non-financial corporations (sector: 1100) and households (sector: 1400)
Source: Reports to the Danish Financial Supervisory Authority and reports to the Danish Nationalbank MFI statistical database

Since the financial crisis, the underlying composition of credit institutions' lending has changed significantly. In 2008, 48 percent of the credit institutions' total lending was in the form of mortgage loans, cf. figure 7. At the end of 2020, this share had increased to 66 percent. This is an increase of almost 20 percentage points over a period of just over ten years. In isolation, this change in loan composition has led to lower earnings in the credit institutions, as a mortgage loan typically has lower earnings per lent krone than a bank loan.

Decreasing interest rates and increasing house prices make it more advantageous and possible for customers (both businesses and households) to increase their mortgages.

**Figur 7: Credit institutions' net interest rates and lending composition**



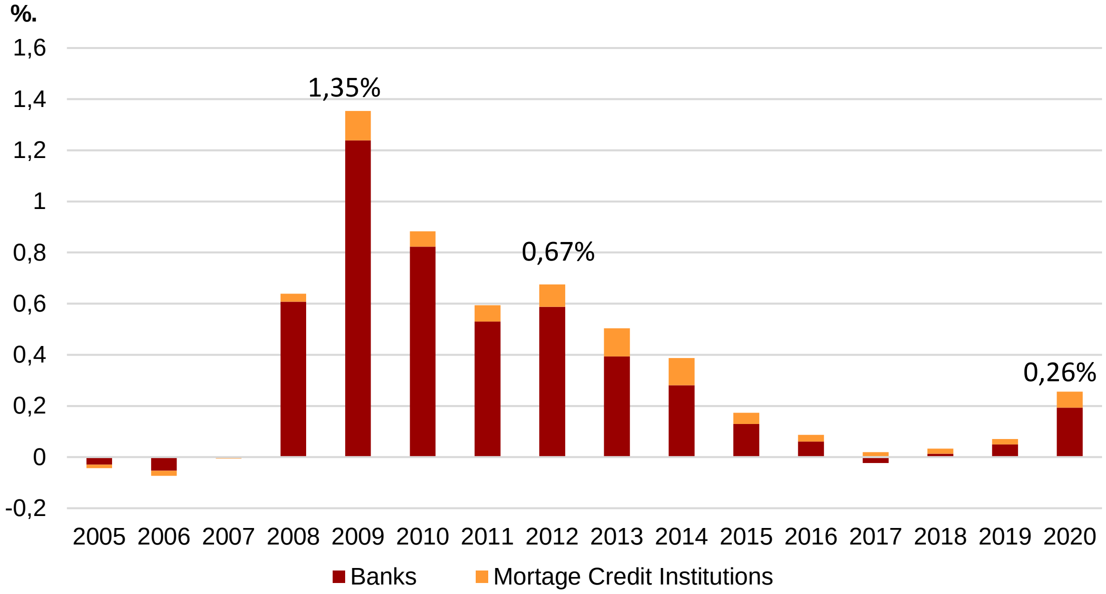

Source: Reports to the Danish Financial Supervisory Authority and reports to the Danish Nationalbank MFI statistical database

*Impairments*

The recognised impairments in percent of the Danish credit institutions' total lending and guarantees increased from 0.07 percent in 2019 to 0.26 percent in 2020, cf.figure 8. Of the total impairments, 75 percent can be attributed to the banks.

Due to the very rapid development of the COVID-19 crisis at the beginning of March 2020, the majority of impairments are in the first quarter. Extensive fiscal assistance packages have contributed to the COVID-19 crisis not being as directly visible as in previous crises in the information that credit institutions receive about their customers. Thus, the impairments have primarily taken the form of managerial estimates.

**Figure 8: Impairments in percentage of total lending**



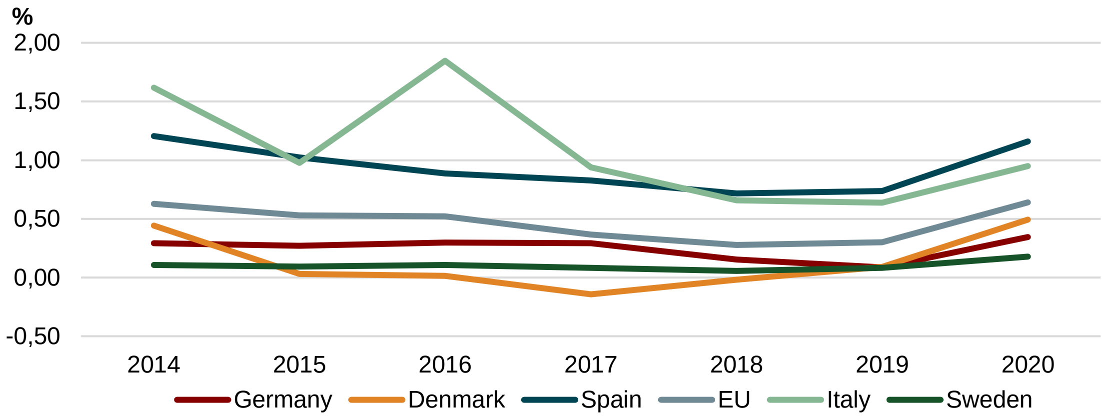

Note: The impairments are in percent of credit institutions' total lending, guarantees and impairments
Source: Reports to the Danish Financial Superviosry Authority

Compared with previous economic downturns, the effect of the COVID-19 crisis on the impairment level remains very low. During the financial crisis and the European debt crisis, 1.35 and 0.67 percent were impaired respectively of the loans in one year. According to the IFRS9 accounting rules, it is important that credit institutions continuously write down the exposures that are exposed. Experience shows that credit institutions do not gain anything by postponing impairments on credit impaired exposures. It impairs timely credit management and reduces the transparency of accounts. Therefore, it is important that credit institutions already write down sufficiently on the exposures that are exposed and not only transiently vulnerable due to the COVID-19 crisis - see also Box 1 on IFRS 9 and management estimates.

During inspections, the Danish Financial Supervisory Authority (hereinafter “the DFSA”) will continue to focus on whether sufficient impairments have been made and that exposures are divided into the correct stages, both on individual exposures and on the credit portfolio as a whole.

International country comparisons and benchmarking on impairments will always be associated with some comparison of “apples and pears” due to differences in macroeconomic developments, the impact of crises and differences in the underlying credit profile of credit institutions' loan records. However, with this reservation in mind, it is still worth noting that the Danish credit institutions realised very low annual impairments up to the COVID-19 crisis compared with the other EU countries, cf. figure 9. On the other hand, impairments in Danish credit institutions are greater than in most other EU countries during the crisis, and at the end of 2020, Denmark was closer to the EU average. There are thus some indications of the Danish credit institutions having been quicker to have their exposures impaired as a result of the COVID-19 crisis compared to their European peers.

**Figur 9: Net impairments in credit institutions across the EU**

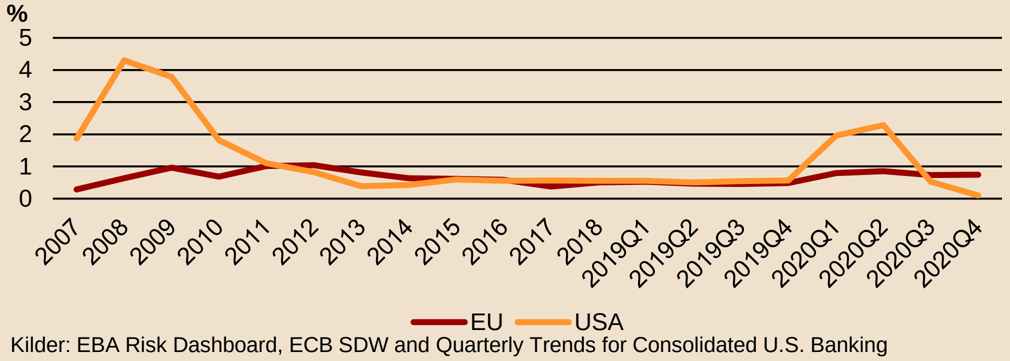



Kilde: EBA Key-Risk-Indicator Database

### Box 1: Impairments in Europe compared to the USA

Historically, credit institutions' impairments and provisions for loans and guarantees have been more volatile and, in times of crisis, averaged higher in the US than in the EU.

**Figure B1.A: Cost-of-Risk in the EU and USA**




Kilder: EBA Risk Dashboard, ECB SDW and Quarterly Trends for Consolidated U.S. Banking Organizations, Federal Reserve of New York (NY Fed).
Note: The figures for the USA are calculated asLoan Loss Provisions (LLP). Cost-of-Risk for the EU corresponds to the operational impairments, and both series of lending.

Currently, the larger provisions and impairments in US credit institutions can be explained by a stronger economic cycle under COVID-19 in the US than in the EU. The pandemic hit the US faster and harder than the EU, but at the same time the recovery has come faster to the US. Unemployment has also increased less in the EU than in the US. In addition, accounting standards are not the same either. In the EU, the IFRS9 accounting rules refer to the international accounting standards from the IASB, where the US standard *current expected credit loss* (CECL) is based on the US Financial Accounting Standards Board (FASB). Under CECL, for example, impairments are made by an amount corresponding to the expected credit loss over the entire life of the loan (lifetime ECL) on all loans, regardless of the stage they are in. Under IFRS9, a 12-month horizon is used for stage 1 loans and only the lifetime ECL for stage 2 and 3 loans. This can have a different effect on the level of impairments in the USA and the EU when the economic cycles are different.

**Box 2: IFRS 9 and management estimates**

The current rules for banks impairments on loans, etc. based on the international accounting standard IFRS 9 were introduced on 1 January 2018. The rules appear from the Executive Order on Accounting for Banks and Others, its appendices 10-11 and the accompanying guidelines on assessing a significant increase in credit risk and credit impairment. In practice, the mortgage banks also use the rules, although individual conditions must be adjusted when it comes to loans at fair value.

The institutions' models for calculating impairments on loans, etc. is mainly based on historical experience and current information about the customers. In addition, a forward-looking element is included based on expectations of macroeconomic developments in the coming years. It follows from IFRS 9 that institutions must include expectations for future development. Thus, relatively large impairments must be expected when the economic conditions are expected to deteriorate. It is also a main purpose of IFRS 9 to ensure that the impairments are not too small and come too late, as happened up until the financial crisis, when there were other impairment rules in effect.

When the COVID-19 crisis hit Denmark and other countries, the macroeconomic situation and expectations for development suddenly deteriorated significantly. As there is no recent experience from an economic crisis caused by such a severe pandemic, the models for calculating the impairments will not show the full problems in relation to COVID-19, and the expectations for macroeconomic development will be associated with considerable uncertainty. The comprehensive government assistance packages have also helped to make it more difficult for the institutions to identify how hard individual customers may have been affected by the crisis and how the customers' situation will be when the assistance packages cease.

Under the given circumstances, many institutions have therefore needed to supplement the impairments with reservations based on management estimates to compensate for the fact that the institutions' impairment methods do not take sufficient account of the deteriorating economic situation.

The DFSA expects the banks and mortgage credit institutions to ensure that their methods and processes for impairments take sufficient account of the continued uncertainty in light of the COVID-19 crisis. But also in the further course of action, it will be necessary for many institutes to supplement the impairments with managerial estimates.

In a memorandum dated 21 December 2020, the DFSA has mentioned the most important observations from supervisory activities with banks 'and mortgage credit institutions' impairments on loans in the autumn of 2019 and in 2020, including e.g. the effect of the changing economic prospects on impairments [1]. In addition, in a letter dated 17 December 2020, the DFSA informed the institutions of matters that they must be aware of when submitting the annual report for 2020, including the application of IFRS 9 and the compatible Danish accounting rules [2].

[1] "The DFSA's observations on credit institutions' impairments on loans, etc.", 21 December 2020.

[2] "Accounting for 2020, etc.", 17 December 2020.

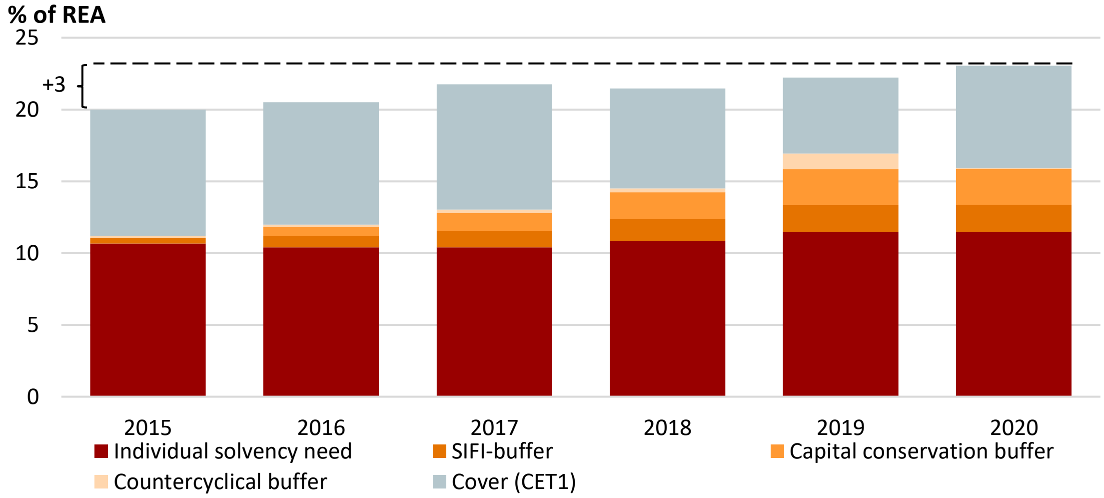
## 4. Capital

The credit institutions' capital adequacy ratio (CAR) was improved during 2020, cf. figure10. This is partly due to the suspended distributions, the release of the countercyclical capital buffer, and the fact that the institutions as a whole came out of 2020 with a positive result. The total amount of capital in the Danish credit institutions increased by DKK 19.5 bn during 2020 to a total amount of DKK 436.5 bn.

Since the financial crisis, the requirements for credit institutions' capital have increased significantly, cf. figure 10. This has especially happened through requirements for establishing capital buffers. There is thus a capital preservation buffer for all institutions and a SIFI buffer for the largest and systemic institutions. In addition, the credit institutions have also had to establish a countercyclical buffer up to the COVID-19 crisis, which the Danish Minister of Business and Industry released on 13 March 2020.

Since 2015, the buffer requirements have increased by 4.7 percentage points, cf. figure 10. They are distributed with 5.2 percent for IRB institutions and 2.4 percent for non-IRB institutions. This is mainly due to the capital preservation and SIFI buffer, which was phased in towards 2019 and now. In addition, the individual solvency requirement has also increased by 1 percentage point for IRB institutions and decreased by 0.1 percent for non-IRB institutions. With the current CAR, the credit institutions have overall increased their capital in relation to the risk exposures (REA) by 3.1 percentage points since 2015. This has happened in the light of the low interest rate environment, the recent release of the countercyclical buffer and the economic downturn due to the COVID-19 crisis. At the same time, however, there is a tendency for the CAR of the regulatory requirements to become smaller as the requirements have become greater.

**Figure 10: Credit institutions' capital requirements**




Note: The excess capital includes the institutions' excess equity tier 1 capital adequacy (CET1), as supplementary and hybrid tier 1 capital (AT1 and T2) cannot absorb losses to the same extent. The individual solvency need consists of 8 per cent. pillar I requirements as well as an institution-specific pillar II requirement. All figures are percent of the risk-weighted exposures (REA). The remaining countercyclical buffer is due to the fact that Norway only partially released their countercyclical buffer, and the credit institutions' Norwegian exposures are therefore still subject to a countercyclical buffer requirement.
Source: Reports to the DFSA

**Box 3: The systemic buffer**

With the implementation of the Capital Requirements Directive (CRD V) in Denmark, a new approach to the systemic risk buffer was introduced. Until 28 December 2020, Denmark has used the legal basis for the systemic buffer (in CRD IV) to set SIFI buffer requirements. From 28 December 2020, the directive's O-SII buffer has been used to determine the Danish SIFI buffer requirements. With the implementation of CRD V, a separate systemic buffer can be determined.

The systemic buffer can be used for the purpose of preventing and hedging long-term systemic or macro-prudential risks that are not covered by other macro-prudential instruments. It can be a general systemic risk and it can be systemic financial risks related to specific groups of exposures. The Minister of Business and Industry determines the systemic buffer. This can be done on the basis of a recommendation from the Systemic Risk Board.

In addition, the Minister of Business and Industry can recognise another country's systemic buffer. If this happens, this systemic buffer will apply to Danish institutions' exposures in the country in question.

*Credit institutions' distributions*

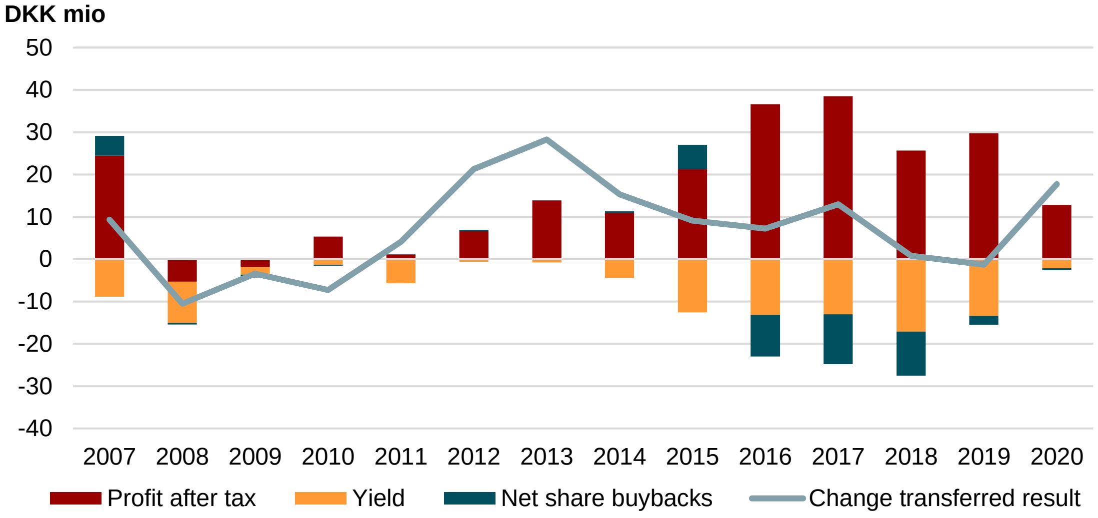
In the wake of the outbreak of the COVID-19 crisis, on the recommendation of the European Systemic Risk Board (ESRB)[2], the DFSA recommended Danish financial companies not to impair their capital base through dividend payments and share repurchases. This recommendation ran until the end of 2020. On 18 December 2020, the DFSA repeated the recommendation[3]. This includes that credit institutions and insurance companies will not make dividend payments in 2020, so the recommendation now applies until the third quarter of 2021. However, the updated recommendation allows companies to make dividend payments if this is done under extreme caution, if the individual company is well-capitalised and if the level of dividend payments is lower than in the years leading up to the COVID-19 crisis.

The updated recommendation is based on the fact that there is still a great deal of uncertainty associated with the COVID-19 crisis, and it is therefore necessary to ensure the resilience of the financial sector.

Figure 11 illustrates the credit institutions' dividend payments and net share repurchases compared with the profit after tax for the year. In 2020, the Danish credit institutions had combined dividend payments based on the result for 2019 of DKK 2.1 bn, which is a decrease of DKK 11.3 bn or 84 percent compared to the dividend payments in 2019 based on the result in 2018. Net share repurchases also decreased by DKK 1.5 billion in the same period. This means that 60.3 percent of the profit after tax in 2018 was paid as dividends, while 8.6 percent of the profit after tax was paid as dividends in 2019.

[2] See first recommendation from the ESRB (link)
[3] See the second press release from the DFSA on dividend payments (link)

**Figure 11: Institutions' dividend payments and share repurchases**




Note: Dividend is based on the result from the year before the dividend. This is set on the basis of the annual accounts and is decided at the next general meeting
Source: Reports to the DFSA

*Capital requirements for credit institutions*

At the beginning of 2020, the capital and debt markets were functioning well, and there was great investor interest in Denmark as well as internationally. However, this was interrupted in March, when markets froze as a result of the COVID-19 crisis. However, the turmoil in the financial markets subsided relatively quickly, e.g. as a result of monetary policy measures by both the ECB and the US Federal Reserve, and in May and June, the largest Danish credit institutions again issued capital and debt instruments, albeit to a limited extent.

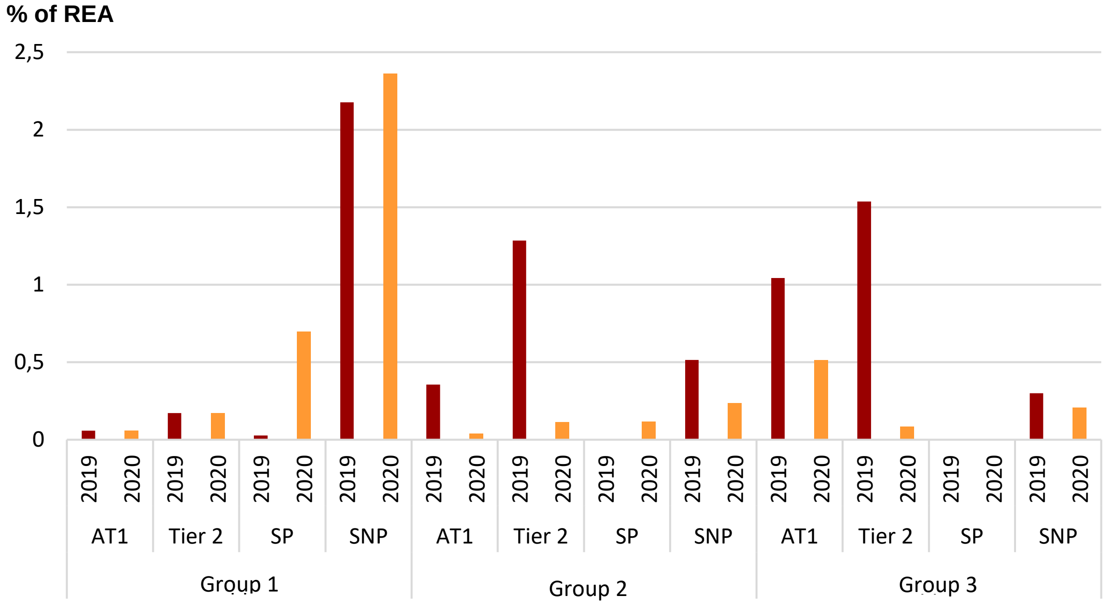
When the DFSA decided on 1 May 2020 to advance future EU rules on lower requirements for subordination of NEP requirements, several of the largest credit institutions chose on that basis to issue ordinary senior debt, cf. figure 12, which is cheaper to issue than non-contingent senior debt.

At the same time, as a result of the COVID-19 crisis, the DFSA extended the phasing-in of the NEP requirement for small and medium-sized banks, in the form of group 2, 3 and 4 banks, by six months until 1 July 2024.[4] It has probably put a damper on the desire to issue NEP debt for the rest of the year from these institutions.

With declining credit spreads as a result of monetary policy measures, the market for capital and debt issues opened more and more into the latter half of 2020 with issues across capital and debt types with a greater investor interest, both in Denmark and internationally. Credit spreads are currently below pre-COVID-19 levels.

[4] See the DFSA's press release (link)

**Figure 12: Issuances in relation to risk exposures**



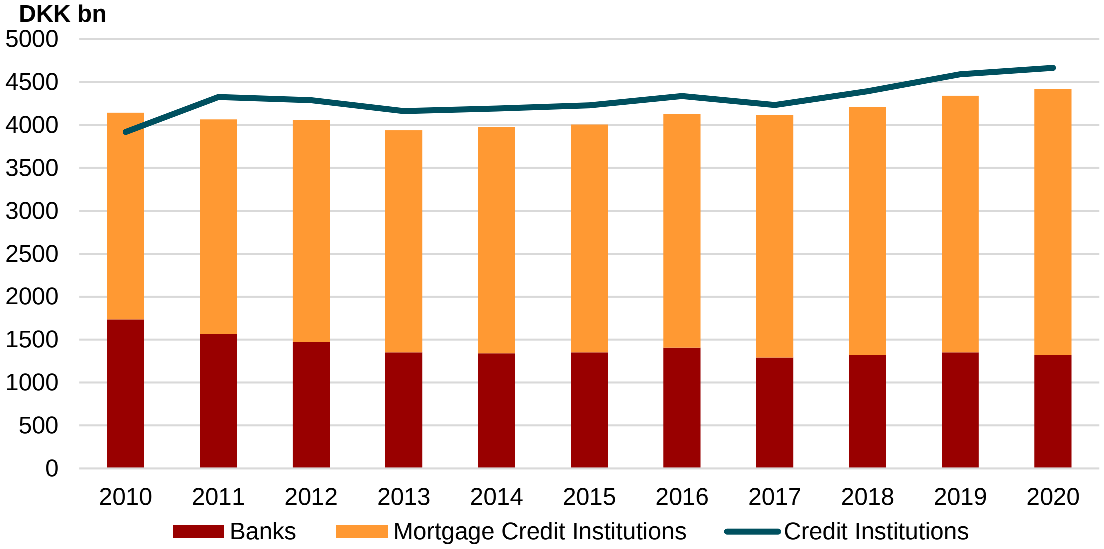

Kilde: Indberetninger til Finanstilsynet.

The total capital and debt issues reached approx. DKK 105 bn in 2020. This primarily covers the build-up of senior debt among the largest institutions to meet NEP and debt buffer requirements, but the replacement of capital instruments for almost DKK 11 bn also contributed. Despite the COVID-19 crisis, the total issue level in 2020 is slightly above the level of DKK 103 bn in 2019.

## 5. Lending growth in credit institutions

Loans issued by Danish credit institutions increased moderately from DKK 4,589 bn in 2019 to DKK 4,664 bn in 2020, corresponding to an increase of 1.6 percent. The increase can be attributed to the mortgage credit institutions only, cf. figure 13. Loans issued by mortgage credit institutions increased by DKK 106 bn or 3.5 percent, while bank loans decreased by DKK 30 bn corresponding to -2.2 percent.

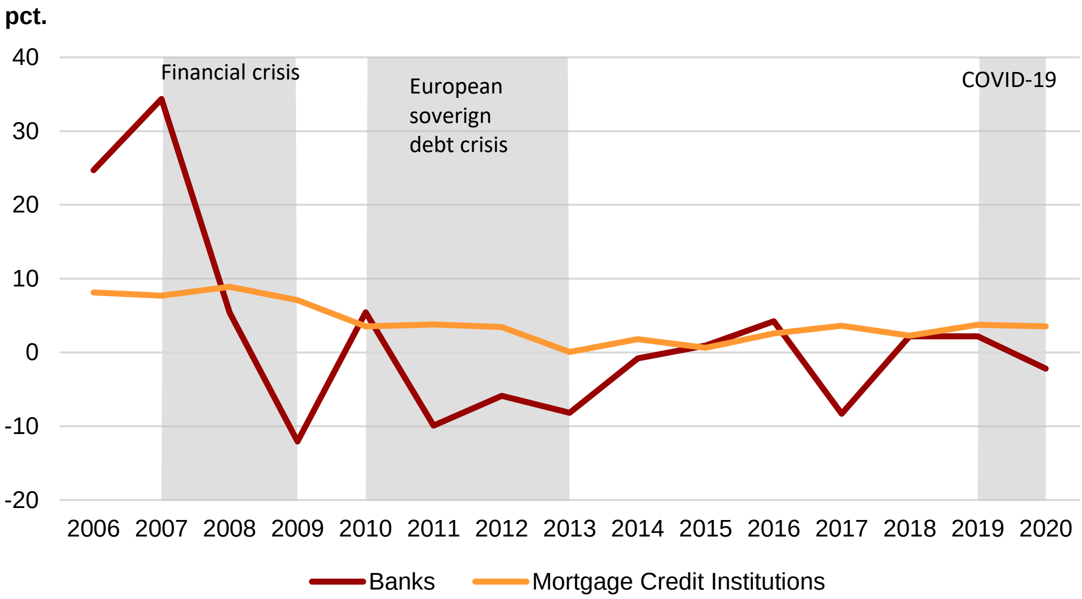
### Figur 13: Bank and mortgage credit institution loans




Note: Note that the sum of lending from banks and mortgage credit institutions, respectively, is not equal to the consolidated lending for credit institutions, this is due to the fact that more activities are included in the consolidated figures, e.g. subsidiaries abroad.Source: Reports to the DFSA

Lending growth in Danish credit institutions has generally been very subdued since the European sovereign debt crisis and has mainly been driven by growth in mortgage loans, cf. figure 14.

**Figure 14: Lending growth for banks and mortgage credit institutions**



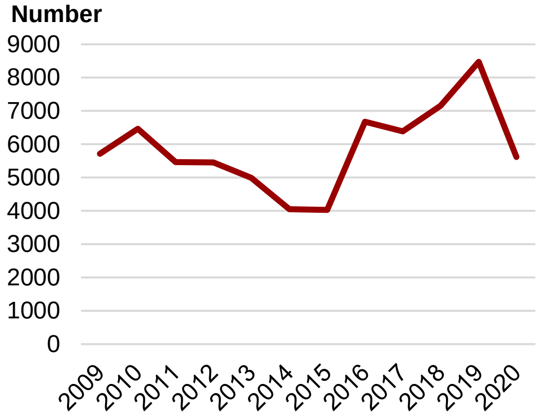

The declining lending growth during the COVID-19 crisis should not be seen only in the light of the economic recession, but is also affected by the extraordinary liquidity transfer that companies and employees have been able to dispose of this year. Among other things, deferred tax and VAT payments of DKK 165 bn[5], "frozen" holiday pay paid of approx. DKK 31 bn after tax[6] and compensation schemes, whereas at 8 March 2021 more than DKK 30 bn has been distributed among 400,000 applicants from companies and employees[7].

The assistance packages cover two opposing effects for the Danish credit institutions. On the one hand, lending growth is declining because assistance packages are absorbing some of the new demand for loans that would otherwise have been there. On the other hand, the current lending volume is supported because the assistance packages keep the hand under companies that would otherwise have gone bankrupt. Thereby, the credit losses are smaller than without the assistance packages. In 2020, 5,614 companies went bankrupt, which is the lowest level since 2015, cf. figure 15.a. Similarly, it can be seen that the assistance packages have limited the unemployment rate compared with previous periods of recession, cf. figure 15.b.

When the assistance packages are phased out, the credit institutions must therefore be prepared for both increased loan demand and increased credit losses. With the IFRS 9 accounting standard, credit institutions must make impairments on the credit impairments that have occurred and on the losses that they expect to occur in the future. The rules therefore stipulate that credit institutions must already now make sufficient and fair impairments on a current credit impairment and not wait until the expiry of the assistance packages.

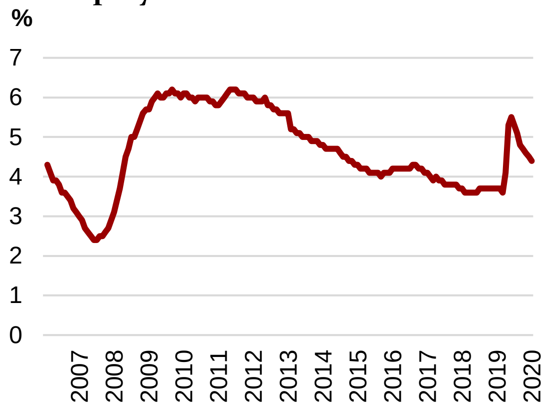
[5] See fact sheet, Danish Ministry of Taxation (link)
[6] See press release from the Danish Ministry of Employment (link)
[7]Danish Ministry of Industry, Business and Financial Affairs (link)

**Figure 15.a: Bankruptcies in Denmark**




Source: Danmarks Statistik, KONK12E

**Figure 15.b: Seasonally adjusted gross unemployment**




Source: Danmarks Statistik, AUS07

## 6. Regulation

*Adjusted phasing in of new regulation after Covid-19*

In April 2020, the European Commission proposed amending the Capital Requirements Regulation (CRR) with the aim of supporting credit institutions in continuing to issue loans to companies and individuals during the COVID-19 crisis and the subsequent recovery of the European economy. The proposal was adopted in June 2020 following a quick process in the Council and the European Parliament. The change in CRR entails i.a. that the phasing in of certain capital requirements was changed so that already agreed easing of the capital requirement came into force earlier than previously agreed (e.g .the exemption for certain software assets from having to deduct the capital base and the extension of the SME rebate) while individual tightening, on the other hand, enter into force later than previously agreed (e.g. extension of the system for mitigating the effect on a capital basis of the transition to IFRS9 and the date of application of the supplement to the leverage ratio requirement).

In addition to changing the phasing in of already adopted EU regulation, the Basel Committee decided in March 2020 to postpone the deadline for implementing the final Basel III recom-

**Box 4: Flexible access during the COVID-19 crisis**

During the COVID-19 crisis, the DFSA has shown a flexible approach within the framework provided in Danish financial legislation and of international regulatory obligations and standards. This has been done without compromising the need to maintain financial stability and confidence in the financial companies. Therefore, throughout the crisis, the DFSA has also emphasised the importance of having correct impairments and ensuring that accounts and capital statements are correct. Nothing is gained by putting the binoculars in front of the blind eye.

The DFSA has continuously communicated on the website about various initiatives and provided guidance to address both regulatory and practical problems in the financial companies as a result of the extraordinary COVID-19 situation.

In response to COVID-19, executive orders have been issued which i.a. regulate deadlines in relation to the submission of annual reports and reporting requirements. With these changes, the DFSA was given the opportunity to grant exemptions to individual companies in certain areas if they experienced practical or administrative issues in meeting the requirements of the regulation as a result of COVID-19 and the infection control measures.

See e.g. the following press releases:

[1] https://www.finanstilsynet.dk/Nyheder-og-Presse/Pressemeddelelser/2020/COVID19_Af clarification_sporgsmaal_relation_den_finansielle_regulering

[2] https://www.finanstilsynet.dk/Nyheder-og-Presse/Pressemeddelelser/2020/Afholdelse_af_generalforsamling_og_indsendingar_aarsrapport_200320

[3] https://www.finanstilsynet.dk/Nyheder-og-Presse/Pressemeddelelser/2020/Covid19_120320

[4] https://www.finanstilsynet.dk/Nyheder-og-Presse/Pressemeddelelser/2020/Finanstilsynet_klar_til_at_dispensere_180320

mendations by one year, so that the recommendations must now be implemented by 1 January 2023 (and the output base implemented by 1 January 1, 2028 at the latest). Against this background, the Commission chose to postpone the submission of proposals for EU implementation of the Basel recommendations accordingly, as a proposal is expected to be presented in 2021.

*NPE backstop*

On 26 April 2019, new EU rules for non-performing loans entered into force. The rules are widely referred to as the NPE backstop.

The purpose of the rules is to prevent the institutions from building up a large stock of distressed loans. The rules mean that an institution's capital can be significantly reduced if the institution does not reduce the amount of loans that have been in distress for more than two years.

With the NPE backstop, a minimum requirement was introduced for hedging losses for a distressed loan. Specifically, the institution's capital is reduced if the minimum requirement for hedging losses is greater than impairments for a distressed loan. The reduction in capital will typically increase relative to the period in which the loan has been in distress. However, a loan must be in distress for more than two years before it can affect capital.

As a starting point, only new loans granted after 26 April 2019 are covered by the rules. Older loans will, however, be covered by the rules if the institution changes terms or increases the size of the loan.

The rules for distressed loans can only begin to affect the institutions' capital from the second quarter of 2021.

*SMV rebate*

The Capital Requirements Regulation (CRR II) implemented a further reduction in the capital requirement for institutional loans to small and medium-sized enterprises (SMEs), which was to enter into force on 28 June 2021. As part of the so-called CRR quick fix, this change was moved forward to 27 June 2020.

The rules only cover exposures to small and medium-sized companies with a turnover of less than EUR 50 million. In addition, these most entail exposures to retail customers or companies or exposures that are secured by a mortgage on real estate. The support factor cannot be used for non-performing exposures.

Under the previous rules, risk-weighted exposures to small and medium-sized enterprises could be weighted down by multiplying by a support factor of 0.7619, provided that loans did not exceed EUR 1.5 million.

With the change in CRR II, the support factor of 0.7619 covers loans up to EUR 2.5 million and loans exceeding EUR 2.5 million can be multiplied by a support factor of 0.85. The reductions mean that the capital requirement will be reduced in relation to the previous rules, as the risk-weighted exposures for small and medium-sized enterprises will decrease.

*The approval requirement for existing financial holding companies*

With the revision of the Capital Requirements Directive (CRD V), a new provision has been introduced in the Danish Financial Business Act, which means that certain financial holding companies must now apply for and be approved by the DFSA. In general, financial holding companies, which in a group constitute the top parent company must apply for approval.

The approval requirement is i.a. introduced to ensure that these financial holding companies have an overview of and management of the relevant risks that arise and go across the entire group. For example, there could be a risk of contagion, concentration and conflicts of interest that can arise when several different financial services are combined. As a result, the approval requirement imposes requirements to the financial holding company having relevant group policies and being organised in such a way that it is possible to attribute risks to the relevant unit in the group.

A financial holding company that meets a number of exhaustive conditions may, when assessing the company's application, be exempted from the requirement for approval. The DFSA will thus, as part of its risk-based supervision, monitor whether the covered financial holding companies meet the requirements for approval or exemption. If this is not the case, the DFSA may make use of a number of supervisory powers that have been introduced with the provision.

The approval requirement came into force on 28 December 2020, after which the covered financial holding companies had to start applying. Financial holding companies that existed on 27 June 2019 have a deadline of 28 June 2021 for applying for DFSA approval.

## Annex 1 – Annual accounts for credit institutions

| | 2016 | 2017 | 2018 | 2019 | 2020 | Change, 1 year | Change, 5 years |
|---|---|---|---|---|---|---|---|
| ***Income statement*** | m DKK | | | | | % | |
| Interest income | 132,269 | 119,240 | 115,063 | 112,714 | 101,372 | -10.06 | -23.36 |
| Interest expenses | 59,892 | 55,654 | 54,098 | 53,533 | 41,177 | -23.08 | -31.25 |
| ***Net interest income*** | ***72,377*** | ***63,585*** | ***60,965*** | ***59,181*** | ***60,196*** | ***1.71*** | ***-16.83*** |
| Dividends on shares etc. | 1,102 | 722 | 778 | ***1,277*** | 657 | -48.55 | -40.37 |
| Fees and commission income | 37,596 | 35,191 | 34,840 | 37,500 | 38,503 | 2.68 | 2.41 |
| Fees and commissions paid | 11,526 | 12,746 | 13,259 | 13,872 | 13,713 | -1.15 | 18.97 |
| ***Net interest and fee income*** | ***99,549*** | ***86,753*** | ***83,323*** | ***84,087*** | ***85,644*** | ***1.85*** | ***-13.97*** |
| Expenses for staff and administration | 57,138 | 48,671 | 50,844 | 52,866 | 54,682 | 3.43 | -4.30 |
| Other operating income | 6,727 | 5,996 | 7,886 | 8,566 | 7,197 | -15.98 | 7.00 |
| Other operating expenses | 504 | 572 | 272 | 420 | 517 | 22.85 | 2.43 |
| Write-offs and impairments on intangible and tangible assets | 5,226 | 5,825 | 5,992 | 9,569 | 8,732 | -8.75 | 67.08 |
| ***Basic earnings*** | ***43,407*** | ***37,682*** | 34,102 | ***29,797*** | ***28,911*** | ***-2.97*** | ***-33.40*** |
| Value adjustments | 7,505 | ***13,515*** | ***6,317*** | ***8,435*** | 7,404 | -12.22 | -1.35 |
| Impairments on loans and receivables | 4,025 | - 202 | ***1,596*** | 3,405 | 13,242 | 288.88 | 228.99 |
| Profit from equity investments in associates | 2,657 | ***1,823*** | 1,316 | 3,456 | ***1,626*** | -52.96 | -38.81 |
| **Profits before tax** | **49,544** | **53,222** | **40,139** | **38,283** | **24,702** | -35.48 | -50.14 |
| Tax | 9,880 | 10,533 | 8,003 | 2,744 | 5,089 | 85.43 | -48.50 |
| **Net profit for the year** | **39,664** | **42,688** | **32,136** | **35,538** | **-19,613** | -44.81 | -50.55 |

Source: Reports to the DFSA.
Note: The figures cover Danish credit institutions and are consolidated so that subsidiaries' earnings do not appear twice.

FINANSTILSYNET

| *Balance sheet items* (m DKK) | 2016 | 2017 | 2018 | 2019 | 2020 | Change, 1 year (%) | Change, 5 years (%) |
|---|---|---|---|---|---|---|---|
| Cash and current receivables from central banks | 83,085 | 118,673 | 70,134 | 152,404 | 413,216 | 171.13 | 397.34 |
| Receivables from credit institutions and central banks | 414,043 | 490,994 | 355,505 | 313,622 | 264,641 | -15.62 | -36.08 |
| Loans | 4,616,350 | 4,483,441 | 4,700,149 | 4,981,761 | 4,954,924 | -0.54 | 7.33 |
| *Loan ex. repo transactions* | *4,335,669* | *4,231,830* | *4,393,576* | *4,587,674* | *4,663,927* | *1.66* | *7.57* |
| Bonds | 937,607 | 805,299 | 766,201 | 842,593 | 975,777 | 15.81 | 4.07 |
| Shares etc. | 50,587 | 46,349 | 32,621 | 38,515 | 42,079 | 9.26 | -16.82 |
| Equity investments in associates | 2,153 | 2,021 | 1,908 | 3,461 | 3,505 | 1.25 | 62.78 |
| Equity investments in associates | 16,858 | 16,623 | 18,544 | 20,491 | 22,013 | 7.43 | 30.58 |
| Asset associated pool schemes | 128,792 | 114,046 | 114,947 | 135,007 | 144,019 | 6.68 | 11.82 |
| Intangible assets | 12,009 | 10,765 | 12,117 | 13,689 | 13,896 | 1.51 | 15.71 |
| Land and buildings | 12,719 | 11,691 | 10,627 | 16,576 | 16,015 | -3.39 | 25.91 |
| Other tangible assets | 10,529 | 11,313 | 11,939 | 13,886 | 13,002 | -6.37 | 23.48 |
| Tax assets | 3,128 | 3,366 | 4,525 | 4,812 | 7,094 | 47.43 | 126.80 |
| Temporarily possessed assets | 1,758 | 1,384 | 2,120 | 3,768 | 1,740 | -53.82 | -1.01 |
| Other assets | 462,211 | 354,111 | 336,540 | 399,918 | 492,266 | 23.09 | 6.50 |
| Prepayments and deferred income | 3,765 | 3,357 | 3,727 | 3,805 | 4,182 | 9.92 | 11.08 |
| **Total assets** | **6,755,595** | **6,473,434** | **6,441,603** | **6,944,306** | **7,368,369** | 6.11 | 9.07 |
| Debt to credit institutions and central banks | 392,286 | 305,841 | 316,985 | 231,340 | 289,563 | 25.17 | -26.19 |
| Deposits | 1,978,791 | 1,832,545 | 1,867,968 | 2,021,848 | 2,250,400 | 11.30 | 13.73 |
| *Deposits ex. repo transactions* | 1,892,935 | *1,689,821* | *1,686,788* | *1,826,733* | *2,096,328* | *14.76* | *10.74* |
| Bonds issued | 3,212,631 | 3,320,239 | 3,270,293 | 3,590,718 | 3,649,206 | 1.63 | 13.59 |
| Other liabilities | 20,013 | 20,010 | *6,912* | 5,572 | 10,558 | 89.49 | -47.25 |
| Prepayments and deferred income | 2,022 | *1,826* | *1,727* | *1,718* | *1,649* | -4.01 | -18.45 |
| ***Total debts*** | ***6,274,984*** | ***6,016,550*** | ***5,986,563*** | ***6,460,372*** | ***6,873,756*** | ***6.40*** | ***9.54*** |
| Provisions | 12,293 | 11,160 | 13,507 | 8,805 | ***8,942*** | 1.55 | -27.26 |
| Postpositive capital contribution | 65,094 | 51,718 | 45,779 | 57,844 | 60,221 | 4.11 | -7.49 |
| Equity | 403,224 | 394,006 | 395,753 | 417,285 | 425,451 | 1.96 | 5.51 |
| **Total liabilities** | **6,755,595** | **6,473,434** | **6,441,603** | **6,944,306** | **7,368,369** | 6.11 | 9.07 |

Note: The figures cover Danish credit institutions and are consolidated so that subsidiaries' earnings do not appear twice.
Source: Reports to the DFSA.

## Annex 2: Key figures for credit institutions

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| | % | | | | |
| **Capital ratio** | 20.74 | 22.14 | 21.69 | 22.47 | 23.28 |
| **Tier 1 capital ratio** | 18.41 | 19.72 | 19.79 | 19.97 | 20.59 |
| **Actual tier 1 capital ratio** | 16.43 | 18.09 | 17.86 | 18.05 | 19.07 |
| **Return on equity before tax** | 12.29 | 13.51 | 10.14 | 9.17 | 5.81 |
| **Return on equity after tax** | 9.84 | 10.83 | 8.12 | 8.52 | 4.61 |
| **Profit per unit of costs (DKK)** | 1.74 | 1.97 | 1.67 | 1.55 | 1.33 |
| **Accumulated impairment percentage** | 1.52 | 1.21 | 1.15 | 1.07 | 1.13 |
| **Impairment percentage for the period** | 0.09 | -0.01 | 0.04 | 0.08 | 0.24 |
| **Loans in relation to equity (ratio)** | 10.75 | 10.74 | 11.10 | 10.99 | 10.96 |
| **Overall risk exposures (DKK bn)** | 2,041 | 1,819 | 1,850 | 1,916 | 1,932 |
| *Of which for credit risk* | 1,685 | 1,520 | 1,536 | 1,599 | 1,603 |
| *market risk* | 151 | 121 | 115 | 120 | 129 |
| *operational risk* | 193 | 170 | 176 | 173 | 174 |

Note: The figures cover Danish credit institutions and are consolidated so that subsidiaries' earnings do not appear twice.
Source: Reports to the DFSA.