



# DENMARK

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### TECHNICAL NOTE—FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

August 2020

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July 15, 2020

# TECHNICAL NOTE

## FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

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. 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>

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## Glossary

BRRD	Bank Recovery and Resolution Directive
DFSA	Danish Financial Supervisory Authority
DGF	Deposit Guarantee Fund, the Danish DIS
DGSD	Deposit Guarantee Scheme Directive
DIS	Deposit Insurance System
DN	Danmarks Nationalbank, the Danish central bank
EBA	European Banking Authority
ELA	Emergency Liquidity Assistance
EO	Executive Order
EU	European Union
FBA	Financial Business Act
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSC	Financial Stability Company
IADI	International Association of Deposit Insurers
MCI	Mortgage Credit Institution
MIBFA	Ministry for Industry, Business and Financial Affairs
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MREL	Minimum Requirements for Own Funds and Eligible Liabilities
NBSG	Nordic-Baltic Stability Group
NCWOL	No creditor worse of than in liquidation
Resolution Act	Consolidation Act on Restructuring and Resolution of Certain Financial Enterprises
SCV	Single Customer View
SIFI	Systemically Important Financially Institution
SPOE	Single Point of Entry
SRB	EU Single Resolution Board

## EXECUTIVE SUMMARY

**Since the 2014 FSAP, Denmark's financial safety net and crisis management frameworks, including bank resolution, have improved significantly.** In response to the FSAP and the transposition of the pertinent European Union (EU) rules, Denmark has enacted major reforms including new legislation for resolution and deposit insurance, introduced a resolution framework for banks and mortgage credit institutions (MCIs), designated two national resolution authorities, established resolution colleges, changed the governance of the deposit insurance system (DIS) and revived cross-border cooperation through the Nordic-Baltic Stability Group (NBSG), including through revising an earlier memorandum of understanding (MOU) and conducting a joint crisis simulation in 2019.

**Denmark's financial safety net rests on sound foundations and its resolution strategy for small- and medium-sized banks has been successfully tested in practice.** The different authorities work well together and exchange information for resolution purposes. Denmark has a solid track record of resolving institutions without the need of public funding but putting the resolution costs on owners and creditors. In the interest of depositors and continuity of services, the authorities apply resolution powers and tools also to small- and medium-sized banks instead of subjecting them to inefficient bankruptcy procedures.

**The governance of the resolution authorities, and especially the Financial Stability Company (FSC), should be strengthened by enhancing its operational autonomy.** The FSC Board should be able to autonomously execute the FSC's mandate without interference from the government or the industry. The government should be involved in resolution decisions only when fiscal support is needed to execute a resolution measure. The company's Board members should serve a term that is disconnected from the political cycle and sufficiently long to ensure the ability to develop pertinent expertise. A formal dismissal procedure should foresee that directors and manager can only be dismissed for certain causes and that a statement of reasons is given for their dismissal. In order to prevent perceived conflicts of interest, rules should prohibit active bankers (members of the Board of Directors or management) to serve as FSC Board members.

**In regard to systemic firms, further efforts are needed to ensure the operational readiness to rapidly execute recovery and resolution measures; some of which the authorities are already working on.** The authorities should accelerate the resolution planning process for systemically important financial institution (SIFIs), in particular the work on the priority areas, such as operational continuity and internal MREL (Minimum Requirements for Own Funds and Eligible Liabilities), identified by the authorities. The testing cycle for SIFIs' capability to deliver crucial resolution data within 12 hours should be expedited and include more than one systemically important institution per year. More conceptual work is also needed, for example, regarding the potential use of a bridge MCI to ensure continuity of critical mortgage-related functions and for the practical execution of the bail-in tool given that the large majority of MREL instruments is held by foreign investors. The authorities should invest more resources in preparing resolution manuals for all resolution tools

available and the use of temporary administration during early intervention. Amending the legislation to not allow the court to delay or reverse resolution measures taken by a resolution authority acting within its legal powers, in good faith which are in part included in the parliamentary explanations of the Resolution Act would enhance legal certainty of resolution decisions and support their implementation.

**The authorities should define strategies for liquidity assistance for institutions in resolution.**

Without such a facility, the resolution framework is missing an important element. An institution in resolution may need liquidity to ensure the continuation of critical functions. The Danish authorities acknowledge the importance of having procedures in place but are following the EU discussions on the topic while exploring different options internally (liquidity provided through ELA, the Resolution Fund with a government backstop or directly via the government). The DN should be able to provide liquidity to enable resolution plans to be put into effect, subject to safeguards, to an institution which is considered systemic and viable and whose solvency concerns will be resolved with certainty and within a short time frame. Authorities will have to assess if the Resolution Fund (with back-up funding from the government) is well suited to secure the needed amounts within a short period of time and on a continuous basis.

**Aspects of the domestic crisis management framework should be further enhanced.** The Coordination Committee for Financial Stability needs to include the FSC as an important pillar of the financial safety net. In particular, the FSC is (1) the resolution authority for gone concern institutions, (2) the manager of the Resolution Fund, and (3) is responsible for the DIS. Although regional cooperation through the NBSG was recently strengthened, domestic contingency planning and crisis preparedness must be advanced. Specifically, under the auspices of the Coordination Committee, nationally coordinated crisis management and communication plans should be developed. The authorities should also test their operation readiness with a system-wide financial crisis simulation exercise.

**Table 1. Denmark: Main Recommendations**

No.	Recommendation	*	**
<b>Institutional framework</b>			
1	Strengthen the autonomy of FSC by (i) giving members of the Board of Directors and management longer contract terms, (ii) allow their removal from office during their term only for reasons specified ex-ante in law or regulation, (iii) limit the decision power of the MIBFA in resolution to situations when fiscal support is needed (MIBFA; ¶15)	MT	H
2	Establish rules for the FSC's Board of Directors which prohibit "active" bankers, including Board Directors of financial institutions, to join the Board (MIBFA; ¶15)	MT	H
<b>Early intervention and recovery planning</b>			
3	Operationalize the temporary administration tool by clarifying qualifications as well as establishing a roster of potential candidates and clarify in the FBA that the cost is borne by the institution under administration (DFSA; ¶18)	ST	M
<b>Resolution powers and planning</b>			
4	Expedite the resolvability of SIFs by (i) finalizing the priority areas for resolution plans and (ii) accelerating the testing of resolution reporting capabilities (DFSA/FSC; ¶133)	ST	H
5	Further operationalize the complete resolution framework, including the bail-in tool, and develop manuals for each resolution power provided by the law (FSC; ¶129)	ST	M
6	Amend the legislation to not allow the court to delay or reverse resolution measures taken by a resolution authority acting within its legal powers, in good faith (MIBFA; ¶128)	MT	M
<b>Deposit insurance and resolution funding</b>			
7	Expand the bank's Single Customer View to ensure tracking of temporary high balances (FSC; ¶138)	ST	H
8	Measure public awareness levels of the DIS regularly to assess the effectiveness of public awareness activities (FSC; ¶139)	C	M
<b>Official financial support (including liquidity in resolution)</b>			
9	Define strategies for liquidity assistance to institutions in resolution (DN/DFSA/FSC/MIBFA/MOF; ¶146)	ST	H
<b>Contingency planning and crisis management</b>			
10	Expand the membership of the Coordination Committee on Financial Stability by making FSC a member of the 2005 MOU (DFSA/DN/FSC/MIBFA/MOF; ¶148)	ST	M
11	Revive the Coordination Committee on Financial Stability and advance crisis preparedness with (i) a system-wide contingency plan; (ii) a crisis communication plan, and (iii) regular multi-agency financial crisis simulation exercises (DFSA/DN/FSC/MIBFA/MOF; ¶148)	ST	H
* Timing: C: continuous; I: immediate (<1 year); ST: short term (1–2 years); MT: medium term (3–5 years).			
** Priority: H: High; M: Medium; L: Low.			

# INTRODUCTION

**1. This technical note reviews Danish financial safety net and crisis management arrangements, including bank resolution.** It summarizes the findings of the FSAP mission undertaken during October 30–November 14, 2019.<sup>1</sup> The note focuses on the authorities' ability to deal promptly, efficiently, and effectively with failing and potentially failing banks, and their preparations for financial distress and crisis. The assessment is based on an analysis of existing legislation and documentation relating to the authorities' policies and procedures, the authorities' detailed responses to a questionnaire prepared before the mission, and discussions with the authorities, the private sector and academia. The current framework was reviewed with reference to the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes and the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems. The note does not reflect a detailed, formal assessment of compliance with either standard. This note is based on the Financial Sector Assessment Program (FSAP) work that was conducted prior to the COVID-19 pandemic and as such did not assess the impact of the crisis and the recent crisis-related policy measures.

**2. This note focuses on the Danish banking sector.** Denmark's financial sector is large (with assets of about 630 percent of GDP), complex, and closely intertwined with that of Nordic and Baltic neighbors.<sup>2</sup> The sector is characterized by a few large groups and many small institutions; in total there are 79 banks and MCIs under Danish jurisdiction. The authorities have designated seven systemically important financial institutions (SIFIs) or groups which include banks and mortgage credit institutions (MCIs)<sup>3</sup>: Danske Bank A/S group (including Realkredit Danmark an MCI), Nykredit Realkredit A/S (MCI) group (including Nykredit Bank), Jyske Bank A/S group (including Jyske Realkredit an MCI), Nordea Kredit Realkreditaktieselskab (MCI, a subsidiary of the Finish Nordea Group), DLR Kredit A/S (MCI), Sydbank A/S, and Spar Nord Bank A/S. The largest is the Danske Bank Group with assets of about 170 percent of GDP. There are 59 other banks which are considered non-systemic and amount to around 10 percent of total credit institution assets. There are also three

<sup>1</sup> This note was prepared by Jan Philipp Nolte, IMF Senior Financial Sector Expert.

<sup>2</sup> Under the Capital Requirements Directive IV and fundamental EU principles of free movement of capital and right of establishment, EU/EEA banks are generally allowed to provide banking services in Denmark on a cross-border basis or through a branch (so called EU passport). The relevant bank must be duly licensed to conduct such services in its home member state. Supervision, resolution planning and deposit insurance coverage falls in the responsibility of the home country authorities.

<sup>3</sup> In Denmark, systemically important financial institutions (SIFIs) are identified at group level once a year. An institution is identified as a SIFI if at least one of the following quantitative criteria is met for two consecutive years:

- The size of the balance sheet is equivalent to more than 6.5 per cent of Denmark's GDP.
- The domestic lending accounts for more than 5 per ½cent of total lending.
- The domestic deposits are greater than 3 per cent of total deposits.

SIFIs are subject to a SIFI capital buffer requirement of 1 to 3 percent of their risk-weighted assets depending on their systemic importance.



large branches of Nordic banks (Finish Nordea Bank and Swedish SEB and Handelsbanken). The seven MCIs exclusively provide real estate loans financed by issuing bonds and are not legally allowed to accept deposits. MCIs which are often part of larger groups rely heavily on the infrastructure and operational functions of the group, for example, by using the bank branch network and through service level agreements.

**3. The legal framework governing the financial safety net, and especially bank resolution and deposit insurance, is mainly shaped by EU legislation, the so-called EU Single Rulebook.**

Denmark as a member of the EU is obliged to transpose EU directives into national law, including the Bank Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Schemes Directive (DGSD).<sup>4</sup> EU regulation in the area of banking applies directly in Denmark (for example, the Commission Delegated Regulation (EU) 2016/1075 specifying, among others, the content of recovery, resolution and group resolution plans). There are also binding technical standards and guidance by the European Banking Authority (EBA) in several areas, for example, on the implementation of a risk-based contribution model for and stress testing of the deposit insurance system (DIS). Because Denmark is not a member of the EU Banking Union, the Single Resolution Mechanism does not apply to Danish banks.

**4. The authorities have addressed the pertinent recommendations of the 2014 FSAP.** The 2014 FSAP made several recommendations, on which the authorities have followed up through:

- Designation of administrative resolution authorities (DFSA and FSC);
- Expansion of the resolution toolkit (including bail-in);
- Preparation of recovery and resolution plans as well as resolvability assessments;
- Introduction of depositor preference;
- Enhancement of the DIS (including, by shortening the payout timeframe to 7 days);
- Establishment of a resolution fund;
- Instituting firm-specific resolution colleges;

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<sup>4</sup> The TN does not reflect an assessment of the grade of compliance of Danish national law with the EU directives. The BRRD was transposed into Danish legislation by two acts: The new Act on Restructuring and Resolution of Certain Financial Enterprises (the Resolution Act) and amendments into existing legislation, the Financial Business Act (FBA) (Chapter 17 and 17a). The FBA contains provisions regarding recovery and resolution planning, assessment of resolvability and powers to address impediments to resolvability, own funds and eligible liabilities (MREL), resolution colleges and powers regarding write down and conversion of capital instruments. The Resolution Act contains provisions regarding conditions for resolution, resolution objectives, valuation, resolution powers and tools, and the use of the resolution fund.

- Enhanced regional harmonization of resolution regimes through parallel transposition of the BRRD into national laws of the Nordic-Baltic region and a joint crisis simulation in 2019.

**5. Since the 2014 FSAP, two banks were resolved under the new framework (Appendix 1).**<sup>5</sup> Both banks were taken over by FSC (the gone concern resolution authority), their management replaced, and their activities are currently being wound down by FSC. Resolutions costs were mainly borne by capital owners and subordinated debt and senior creditor holders through a full bail-in for loss-absorption. In the case of one bank, the DIS contributed to the resolution, insulating the insured depositors from losses through a bail-in.

## INSTITUTIONAL FRAMEWORK

**6. Denmark's framework for crisis management and financial safety nets comprises five institutions: DN, DFSA, FSC, MIBFA, and MOF.** The institutional arrangements are well established. Roles, responsibilities, accountabilities and information sharing arrangements are generally well defined. The DN, DFSA, MIBFA, and MOF have a Memorandum of Understanding (MOU) in place which details information exchange as well as cooperation for crisis management purposes. FSC is not fully incorporated into these system-wide arrangements but attends meetings of the group as a guest regularly.

**7. The Danmarks Nationalbank (DN) is the monetary authority and lender of last resort.** DN's mandate includes maintaining a safe and secure currency system in Denmark and a stable financial system. It is responsible for the interbank payment system and may grant ELA to institutions that are solvent but face liquidity difficulties against adequate collateral. DN does not exercise any supervision or resolution functions. It is consulted by DFSA on the content of resolution plans for systemic institutions and participates in resolution colleges as an observer. It also monitors and assess financial stability in Denmark with focus on the overall financial system. The DN is the secretariat for and the governor chairs the Systemic Risk Council which has an advisory function to monitor and identify systemic risks and to issue statements and warnings about developing risks.

**8. The Danish Financial Supervisory Authority (DFSA) is both supervisory and resolution authority, the later one a shared responsibility with the FSC (see Box 1).** The overall objective of the DFSA is to ensure financial stability and confidence in financial institutions and markets. It is responsible to protect the functioning of financial markets and to supervise the banking, insurance, and securities sectors. The agency is the acting resolution authority until an institution meets the triggers for resolution (going concern resolution authority) with main responsibilities in recovery and resolution planning and the removal of impediments to resolvability. DFSA's resolution unit is part of the capital markets department and therefore separated from the agency's supervisory functions. DFSA also prepares all new financial legislation for MIBFA. It is an agency within the MIBFA.

<sup>5</sup> Andelskassen J.A.K Slagelse (October 2015) and Københavns Andelskasse (September 2018).

### Box 1. The Danish Resolution Authorities: DFSA and FSC

The DFSA and FSC share the responsibilities for resolution of banks and MCIs in the following way:

**Going concern** resolution authority is DFSA which

- Is point of contact for institutions in going concern,
- Collects relevant information from institutions (e.g. for preparing resolution plans and setting MREL),
- Approves the resolution plans (following recommendations from FSC and for systemic institutions in consultation with DN),
- Is empowered to issue orders to address or remove impediments to resolvability,
- Sets and monitors MREL requirements (after consultation with FSC), and
- Signing joint decisions on resolution plans and MREL within resolution colleges while the institutions are in going concern.

**Gone concern** resolution authority is the FSC which

- Is point of contact for institutions in resolution,
- Develops the resolution plans (in cooperation with DFSA's Resolution Unit and—for systemic institutions—DN),
- Takes control of the resolution process once an institution is assessed by DFSA's supervisory authority as failing or likely to fail,
- Assesses whether the public interest test is fulfilled which determines if a failing institution is resolved through the resolution framework or liquidated through bankruptcy proceedings,
- Is empowered to apply resolution powers and tools, and
- Signs joint decisions with other resolution authorities while the institution is in resolution.

Coordination and information exchange between the two authorities are regulated in the Cooperation Agreement between DFSA and FSC from August 2019. Among others, the agreement foresees quarterly meetings between the agencies at the management level to discuss general supervision of institutions, resolution plans and preparedness of institutions to provide information in resolution as well as MREL requirements. The MOU has provisions on information exchange and cooperation in domestic and international matters as well as legal proceedings.

**9. FSC is an independent public entity which is resolution authority and responsible for the deposit insurance system (DIS).** The objectives of the FSC are to contribute to ensuring financial stability in Denmark, manage the responsibilities and powers assigned to it under the

Resolution Act, the Deposit Insurance Act and any other tasks or responsibilities assigned to it by legislation or directly by MIBFA. The FSC was established in 2008 as response to the financial crisis as a limited company owned by the Danish government (MIBFA) with a mandate to resolve failing banks. It was appointed resolution authority together with DFSA in June 2015 and its legal form changed to its current status. The assets and liabilities of the formerly independent DIS were transferred to FSC in the same year. The DIS provides coverage for depositors and investors of all Danish banks, MCIs and investment companies as well as certain investment management funds.<sup>6</sup> The FSC becomes the acting resolution authority when the conditions for resolutions are met (Box 1). The company's business areas comprise of the remaining Bank Package I-V activities (legacy portfolio of the global financial crisis), the Resolution Fund, and the Guarantee Fund (the DIS), but with a statutory requirement for the separate management of the assets of the individual segments. FSC is not liable for the Guarantee Fund or the Resolution Fund, and these are only liable for their own obligations and liabilities. The funds are not independent legal entities, and the FSC acts on their behalf (for example, when applying for back-up funding from the government). FSC is subject to annual audits. Since 2008, FSC has resolved 17 financial institutions and was involved in private-sector solutions which prevented a resolution. FSC is also pursuing several liability lawsuits against the former management of failed banks.<sup>7</sup>

**10. The Ministry for Industry, Business and Financial Affairs (MIBFA) is responsible for the financial sector and sets, among other things, the policy framework for crisis management and bank resolution.** The MIBFA has various powers pursuant to the FBA (e.g., approves mergers of banks), which mostly have been delegated to the DFSA. It also issues executive orders, rules, and regulations for the implementation of the FBA and other financial sector laws. MIBFA is the decision-making authority for the countercyclical capital buffer, the SIFI buffer, and the systemic risk buffer. The ministry has overall responsibility for the DFSA and the FSC.

**11. The Ministry of Finance (MOF) participates in government and parliamentary procedures on state granted re-lending for the safety net (back-up funding).** By law, the FSC has access to back-up funding from the MOF in the form of state granted re-lending as a last resort. Other responsibilities of the MOF include the drafting Denmark's budget (the Finance Act) and the country's economic policy and analysis of macro-economic developments.

**12. The MIBFA is responsible for FSC, and therefore plays a strong role in the governance of the organization including dismissal of a Board of Director's member without cause at any time.** The FSC is run by a Board of Management, currently with three members, and governed by a Board of Directors, with up to seven members. The management is nominated by the Board of Directors, which is nominated on an annual basis by the MIBFA. The minister may, at any time, at a

<sup>6</sup> The Guarantee Fund does not only act as the deposit insurer but also as an investor compensation fund. In transposition of an EU directive, investors in Denmark may receive compensation of approximately DKK 150,000 (EUR 20,000) in the event of failure to return securities which belong to the investor and which are managed or held by the institution.

<sup>7</sup> FSC is suing persons when it believes that it is more than likely that a court will rule in favor of FSC.

general meeting dismiss the appointed members of the Board.<sup>8</sup> Despite one-year terms, in practice, current Board members have served on average for four years and more. The Board of Directors discusses resolution strategies and resolution plans of individual institutions as well as MREL requirements. It would also discuss concrete resolution actions for SIFIs and present the minister with a recommendation about the resolution tools to be used. The company's management runs its daily business, including the resolution of small and medium institutions autonomously and on an arms-length basis from the ministry. FSC also has an obligation to inform MIBFA of any matters with a political or economic impact (e.g. out of court financial settlements with former management of failed banks). The company's administrative costs, which include a staff size of over 50, are borne by the three funds it manages (Bank Packages, Resolution Fund, and DGS).

**13. The DFSA's operational independence is compromised, both through governance arrangements and through resource constraints.**<sup>9</sup> Appointments to the Supervisory Board are made by the Minister of the MIBFA and are for a duration of two years only, although re-appointment is permitted. Additionally, the Minister appoints a Ministry observer to the Supervisory Board, with speaking, but not voting, rights. A dismissal procedure for a board Member does not currently exist. 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. The DFSA is funded through fees charged to the supervised institutions, but subject to budget approvals imposed by the MIBFA and Ministry of Finance.

**14. For systemically important institutions the Minister of Industry, Business and Financial Affairs decides on the choice of resolution tools.**<sup>10</sup> Resolution strategies for SIFIs are discussed in general in the Coordination Committee on Financial Stability and the cross-border resolution colleges, in which the MIBFA participates thereby gaining insights into the resolution plans. In an actual resolution case, and while not specified in any law or MOU, the minister would make its decision on the basis of a recommendation of FSC laying out the concrete resolution strategy and after a discussion in the Coordination Committee. The decision would also involve consultation with the MOF (the fiscal authority) if the need for back-up funding from the government (state re-lending) arises.

**15. The resolution authorities, especially FSC, should have their operational autonomy strengthened.**<sup>11</sup> FSC's Board should be able to autonomously execute the authority's mandate without interference from the government or the industry. The government should be involved only when fiscal support is needed to execute a resolution measure. The agency's Board members should serve a term that is disconnected from the political cycle and sufficiently long to ensure the ability to

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<sup>8</sup> Section 67 (2) Resolution Act.

<sup>9</sup> See 2020 TN on Banking Regulation and Supervision for recommendations pertaining to independence of the DFSA.

<sup>10</sup> Section 12 (6) Resolution Act.

<sup>11</sup> FSB Key Attribute 2.5, IADI Core Principle 3.

develop pertinent expertise. Typically, this would require a term that is longer than the term of the officials involved in the appointment. A formal dismissal procedure should foresee that directors and manager can only be dismissed for certain causes and that a statement of reasons is given regarding the dismissal. In the past, board directors of financial institutions have been allowed serving at the same time at FSC's Board of Directors. While these persons were excluded from discussions about the institution they were affiliated to, the practice of not prohibiting "active" bankers to serve can lead to perceived conflicts of interest, for example, when general resolution strategies or MREL requirements as well as market-sensitive information about competitor banks are discussed. The governance framework should foresee rules which prohibit active bankers (members of the Board of Directors or management) to serve as FSC Board members and ensure that conflicts of interests are fully disclosed before joining. All these issues related with the operational autonomy of the resolution authority should be enshrined in the legal framework.

## EARLY INTERVENTION AND RECOVERY PLANNING

### A. Early Intervention

**16. The Financial Business Act (FBA) gives the supervisory authority within DFSA early intervention powers in cases where a bank or MCI breaches (or it becomes highly probable that it will breach) legal requirements, among others, capital requirements.**<sup>12</sup> The DFSA may order the institution to implement one or more measures as laid out in the FBA within a set time limit. For example, the supervisor may order: To set in motion or update the recovery plan; to convene a meeting of shareholders; that one or more members of the Board of Directors or management must resign; to restructure debt; and/or to change the business, legal or organizational structure. Measures could also be based on section 350 FBA<sup>13</sup> which gives the DFSA far reaching powers to take remedial action without limiting them to a defined catalogue as the section on early intervention does. Examples for measures implemented in the past are the restriction of activities, suspension of dividends, and changes of management. If the institution does not implement the measures within the prescribed time limit, DFSA may withdraw the license. The DFSA has intervened in banks as recently as end-2018. In accordance with section 372(1) FBA, decisions made by the DFSA may be brought before the (external) Danish Company Appeals Board or in front of the civil court system. Both institutions would decide whether to apply a suspensive effect or stay on the measures after hearing DFSA.

**17. The DFSA's decision about whether the conditions for early intervention are met is part of the ongoing supervision of the institution and FSC is informed at an early stage of institutions facing problems.** DFSA has an internal business procedure on Early Intervention and Management of Distressed Undertakings (business procedure number 9) which defines its internal

<sup>12</sup> Section 243a FBA.

<sup>13</sup> The criterium for intervention under section 350 FBA is that "the financial position of the undertaking has deteriorated to such a degree that the interests of depositors or bond owners are endangered and there is no insignificant risk that the situation will deteriorate further resulting in the loss of the license".

processes related to handling a problem bank, including different procedural steps and information exchange within the agency as well as with external stakeholders (FSC). However, the procedures could offer concrete guidance on how to recognize that a bank is in need of early intervention. Additional guidance is given in DFSA's crisis manual which also contains a chapter on sanctioning powers for institutions in crisis (recovery and early interventions, sanctions in case of non-compliance with prudential requirements, revocation of banking licenses). DFSA informs FSC as soon as possible of observations made in institutions which could be relevant for FSC's work, for example, for the purpose of general resolution planning as well as preparatory work for concrete resolution. FSC is also informed about which institutions are under intensified supervision, when an institution is in breach of the MREL requirements, and when an institution fulfils the requirements for early intervention and intervention measures are implemented. If the situation within an institution under intensified supervision deteriorates further towards potential resolution, it is foreseen that DFSA would inform FSC on a frequent basis. FSC may require DFSA to test the resolution preparedness of any institution which satisfies the terms for early intervention.

**18. DFSA has the power to install a temporary administrator, but still needs to operationalize this option.** If the financial situation of a bank or MCI deteriorates substantially or there are serious breaches of the law, the DFSA may replace the management and the Board of Directors and install a temporary administrator. The administrator can either be tasked to replace the Board of Directors or to assist the Board in its work. The DFSA would detail the scope of the administrator's assignment in an order, including for which decisions he/she would need to seek pre-approval from DFSA. Temporary administration can last for up to one year; under exceptional circumstances DFSA may extend this period. DFSA has so far not made use of this power<sup>14</sup> and has not adequately prepared for the use of it as only some aspects (for example, remuneration of the administrator) are described within DFSA's Crisis Management Manual. The agency should define in advance the qualifications for special administrators, and prepare as well as regularly update a list of pre-approved potential administrators who meet the qualification criteria. The FBA should be amended to clarify that the cost of special administration is borne by the institution under administration (currently this is only stated in the official notes to the FBA).

## B. Recovery Planning

**19. All institutions are required to maintain recovery plans, but subject to proportionality.** All banks and MCIs under Danish jurisdiction have a recovery plan approved by DFSA's supervisory authority in place. The outline of the plans depends on the size of the institution, its complexity and risk profile. DFSA allows simplified recovery plans for institutions that have total assets below DKK 12 billion. For institutions with total assets below DKK 1 billion, the requirements are even simpler, and they are not required to provide DFSA with an annual recovery plan. Instead, these institutions must only update the plan if material changes occur and submit an annual capital raising plan instead.<sup>15</sup> SIFIs have to report an updated recovery plan to the DFSA every year. Upon receipt, DFSA

<sup>14</sup> Appointing a temporary administrator can be destabilizing and therefore this tool has to be used with caution.

<sup>15</sup> Currently, 17 banks are not required to submit an annual recovery plan.

submits the recovery plan to its own Resolution Unit and FSC for comment. If the authorities find the original plan to contain significant shortcomings, then the institution has to submit a revised plan. DFSA otherwise sends a letter to the institution that it takes note of plan and has no (further) comments. Group recovery plans are also being discussed within the cross-border colleges for supervision as well as for resolution which provide a joint response to the institution.

**20. DFSA has detailed the requirements for recovery plans in an Executive Order (EO) and a guideline and the expectations of the supervisor are well established and understood by the institutions.**<sup>16</sup> The EO lists in detail a number of areas that must be addressed in a recovery plan, for example, a description of a number of different stress scenarios for the individual institution or the financial system. For each scenario, the plan must describe an appropriate response and explain how the institution will recover. Furthermore, Danish institutions are required to fulfill the Commission delegated regulation ((EU) 2016/1075) which includes requirements for the contents of recovery plans. In addition, the plans lay out how the institutions can fulfill their reporting duties for resolution purposes, issues of interconnectedness and critical systems as input for the resolution planning process. The final plans are approved by the Board of Directors of the institutions. DFSA and the industry are in a regular dialogue about the plans. In the beginning, the DFSA found different deficiencies in the recovery plans, mainly for the smaller banks. These shortcomings have been addressed by the institutions.

## RESOLUTION POWERS AND PLANNING

### A. Resolution Powers

**21. FSC has a broad range of bank resolution powers that are closely aligned with the FSB Key Attributes (Key Attribute 3) and set-up within the framework prescribed by the EU BRRD.** The framework applies to Danish banks, MCIs and certain investment firms as well as to group parent companies of a financial group or conglomerates, branches of foreign credit institutions and group companies that carry out significant functions. FSC can make use, either separately or in combination, of the following resolution powers and tools:

- Remove and replace the governing bodies (management and Board of Directors) of the institution or a financial group;
- Take control over the institution and assume the powers of shareholders and the Board of Directors;
- Appoint a special manager and dismiss the Board of Directors and management;

<sup>16</sup> Executive Order no. 724 of 27 May 2015 about Recovery Plans for Banks, Mortgage-credit institutions and Investment firms (the EO was not shared with the mission).



- Impose the continuity of important services on the relevant entities;
- Transfer assets, liabilities and contracts to other legal entities or to a bridge bank;
- Establish a bridge bank;<sup>17</sup>
- Establish an asset management vehicle and transfer assets to it<sup>18</sup>;
- Temporarily stay the exercise of early termination rights and suspend payment obligations;
- Bail-in creditors of the institution; and
- Write down or convert relevant capital instruments into equity.

**22. DFSA as supervisory authority is responsible to assess whether or not an institution is failing or likely to fail in consultation with FSC, while FSC would decide if an institution will enter into resolution or be subject to bankruptcy proceedings.** The triggers for resolution are clearly specified. FSC can initiate resolution actions against a institution when the following conditions for resolution are met: (i) DFSA has notified FSC (a) that the institution is failing or likely to fail and (b) that there is no reasonable prospect that any alternative measures, including by the private sector, would prevent the failure of the institution within an appropriate timeframe, and when in FSC's view (ii) the public interest demands one or more resolution measures to be taken (instead of initiating bankruptcy proceedings). FSC must choose the resolution measure(s) that are most suitable to preserve the public interest, taking into account, for example, the stability of the financial system, the continuity of critical functions and the protection of depositors and public funds. In an actual resolution situation, FSC can diverge from the resolution plan as it deems necessary to achieve the resolution objectives. An independent valuation of the assets and liabilities of the bank is foreseen to ensure that creditors do not suffer greater losses as result of resolution compared to liquidation (NCWOL principle). FSC's preferred method due to likely time constraints in resolution is a provisional valuation done by the company itself, later verified by an independent valuation. For this purpose, FSC has contracted audit firms after a public tender.

**23. Denmark's preferred resolution strategy for its SIFIs and other institutions is a single point of entry (SPOE) open bank bail-in and to support this all banks are subject to MREL.** In resolution, capital instruments will be written-down and/or converted and, if necessary, the bail-in tool will be utilized to ensure sufficient loss absorption and recapitalisation. MREL is set at two times the total capital requirement including capital buffer requirements (except for one countercyclical buffer)". MREL took effect for the systemic banks on 1 July 2019 and all fulfill it.<sup>19</sup> DFSA sets

<sup>17</sup> FSC would own the bridge bank/institution during the resolution of an institution. The bridge bank would be capitalised though a write down of relevant capital instruments, bail-in and funds from the Resolution Fund.

<sup>18</sup> FSC would own the AMV and it would be capitalised though funds from the Resolution Fund.

<sup>19</sup> Spar Nord which was only recently designated a SIFI does not have to meet its MREL requirement until 2022.

individual MREL for institutions after consulting the FSC and based on the resolution plan. The Danish approach allows for a phasing-in period for the subordination requirement (full subordination) until 1 January 2022.<sup>20</sup> Systemic institutions have jointly issued non-preferred senior debt amounting to DKR 75 billion at end of April 2019. Non-residents hold 92 percent of the non-preferred senior debt issued by banks, while Danish banks hold less than 1 percent of the issue. Rules are in place to prevent that unsophisticated retail customers invest in MREL instruments. A breach of MREL requirements is not considered an automatic entry into resolution but would trigger intensified supervision. Internal MREL policies are under development.

**24. For small- and medium-sized institutions, the preferred resolution strategy is similar to that for SIFIs when it comes to the use of resolution tools.** In the authorities view, even small banks pass the public interest test (required under Art. 32 (5) BRRD) because of depositors' need to access their deposits and the payment system (as most daily payments are made through electronic transfers) without any interruptions. The Danish bankruptcy regime would not adequately ensure the continuity of these functions. Under the Danish resolution strategy, losses of the failed institution would be absorbed through write down of relevant capital instruments and if necessary a bail-in. FSC would then take control of the institution and replace its management with its own qualified staff, transferring the ownership of the bank to a bridge bank holding<sup>21</sup> owned by FSC and after this transfer either sell its assets or wind-down the institution under FSC's control (controlled liquidation). The use of a holding structure and the transfer of the whole institution allows the banking activities to continue with the same banking license and without renewing the registration of collateral. As FSC sees its role as an integrated resolution authority and liquidator for failed institutions it does not see the need to separate good from bad assets. Instead, it deals with the bad assets in form of NPL work-outs or selling asset portfolios. The resolution scheme is pre-approved under the EU state aid regime for institutions with total assets of less than EUR 3 billion.<sup>22</sup> Larger institutions would be subject to a case-by-case approval procedure.

**25. MCIs are exempted from MREL requirements and the application of the bail-in tool.** MCIs must instead comply with a debt buffer requirement of 2 percent of lending to ensure that there is sufficient loss absorption capacity. The MCI debt buffer will be fully phased-in to in 2020 (in 2019, it is 1.8 percent on average). Due to the exemption, for groups consisting of an MCI and a bank, MREL only applies for the group's banking activities. Furthermore, liabilities and own funds used to fulfil bank's MREL cannot be simultaneously used to fulfil the capital and debt buffer

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<sup>20</sup> Danish subordination requirements are more stringent than required under BRRD. Authorities are waiting for EBA standards in order to assess the implications of BRRD 2 for the Danish resolution strategy as it will set limits for subordination.

<sup>21</sup> The bridge bank holding is capitalized by the resolution fund, and the bridge holding will, if required, temporarily recapitalize the failing institution, but not absorb any losses.

<sup>22</sup> The pre-approval is subject to a number of conditions, including that a conversion/write-down of shareholders and subordinated debt is always required, the failing institution will cease to exist, and an open and competitive sales process on market terms be held for its assets. The remaining activities need to be wound up and the banking license revoked no later than two years after the resolution date.

requirements that apply to MCIs. For groups, the sum of the MREL for the group's banks and the capital and debt buffer requirements for the group's MCI must constitute at least 8 percent of total liabilities and own funds. For all groups including MCIs, SPOE is the preferred strategy as it would keep the group together in resolution and the MCI will be supported by the parent entity. For MCIs which are not part of a group, the resolution strategy is to recapitalize the institution through a conversion of the debt buffer and the use of a bridge holding MCI. Even though MCIs are exempted from bail-in, it is possible to write-down and convert MCIs' debt buffer as DFSA requires that the liabilities to fulfil the buffer need to include contractual clauses that allow their write-down or conversion without the use of bail-in.<sup>23</sup> MCIs that are subsidiaries and part of an SPOE-strategy must, in addition, issue the liabilities to the parent company which can be written down.

**26. In the unlikely event, that the FSC assesses that resolution is not in the public interest, institutions can be subject to bankruptcy proceedings under the Danish Bankruptcy Act.** The general bankruptcy framework for commercial firms is only slightly modified through the FBA. Bankruptcy is initiated by an application to the local Bankruptcy Court from the bank itself or from one of its creditors. The Bankruptcy Court must notify DFSA and FSC about the application as it cannot commence bankruptcy proceedings if within seven days FSC takes the decision to apply resolution measures instead. DFSA can also revoke the license and submit a bankruptcy petition when a bank becomes insolvent. The DFSA's decision to petition may not be appealed against. After issuing the bankruptcy order, the court would appoint, after consultation with DFSA, one or more trustees. The trustee is to take charge of liquidating the failed bank's assets and pay out its liabilities. A draft of the financial statements and distribution of recoveries is first presented to DFSA for a statement before it is submitted to Bankruptcy Court. Once the trustee is appointed, DFSA is entitled to participate in meetings of the creditor committee and the committee of inspection.

**27. Resolution powers and tools are in general also applicable to MCIs, but the law foresees a special bankruptcy framework for MCIs in contrast with banks.** The commencement of bankruptcy proceedings against an MCI does not, as per the Mortgage-Credit Act, give rise to any early repayment of the bonds and derivative contracts. Instead, a liquidator will ensure continued performance, to the extent possible, of the MCI's obligations, with the distressed MCIs capital centers being wound-up in accordance with the repayment schedule of the underlying mortgage loans. To facilitate such a process, the liquidator may raise additional loans (e.g., via the issuance of junior covered bonds, secured by the asset pool but subordinated to other bonds), refinance maturing bonds and provide additional collateral. A mandatory maturity extension of the bonds in case of a failed refinancing seeks to provide a safeguard against severe funding pressures that may otherwise arise due to the bankruptcy of the MCI. There are no practical experiences with the bankruptcy regime for MCIs. Due to the importance of the mortgage sector, instead of bankruptcy the strategy for MCIs would be to resolve the institution under the resolution framework.

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<sup>23</sup> Code on guidance on liabilities for meeting debt buffer requirements from November 4, 2019.

**28. FSC exercises resolution powers without any ex-ante court involvement.** However, resolution actions are subject to ex post judicial review. Decisions made by FSC during resolution may be brought before the courts by individuals, who have a legitimate legal interest in the matter and would – if successful – be limited to compensation by the Resolution Fund. The ex post judicial review of resolution actions is referred to in Section 11 of the Resolution Act which stipulates that the valuations carried out by FSC in accordance to the Resolution Act cannot become subject to separate judicial review but may be reviewed solely in conjunction with FSC’ implementation of resolution measures. The limited role of courts in resolution is described only in the parliamentary explanations to the Resolution Act. As stated in the parliamentary explanations, the matter of whether a lawsuit brought before the courts has a suspensory effect is a matter for the court’s decision.<sup>24</sup> The legislation should be amended to not allow the court to delay or reverse resolution measures taken by a resolution authority acting within its legal powers, in good faith<sup>25</sup>.

**29. FSC should invest more resources in preparing resolution manuals for all resolution tools available and to further operationalize resolution tools.** While FSC has resolution manuals in place for all the tools used in its preferred resolution strategy, manuals for tools not foreseen (for example, asset separation tool) are not prepared. As a matter of preparedness, FSC should do conceptual thinking of being able to utilize the full toolkit at its disposal. The transfer of the full bank under the holding structure may not secure the best resolution outcome when dealing with a bank with large bad assets. Alternative resolution strategies should be developed which would allow for the transfer of only performing assets and liability under the bad bank. Furthermore, the complex bail-in tool warrants more attention. Preparatory steps to ensure that the bail-in mechanism is operational may include, for example, drafting the necessary legal documentation, entering into contracts, and drafting playbooks with central security depositories and stock exchanges to ensure that investors with bail-in-able bonds can be identified, and how old shares can be canceled, and new shares delivered into the accounts. FSC has identified this issue as a priority.

## B. Resolution Planning

**30. Fully fledged resolution plans for systemic institutions and groups are developed annually in close cooperation between the FSC, DFSA’s Resolution Unit, and DN.**<sup>26</sup> A Steering Committee with high-level participants from all three organizations coordinates the collaboration, discusses the resolution plans (including, input from the resolution colleges), identifies obstacles to resolution and their removal, and monitors the progress in the development of the resolution plans based on the priority areas for each year’s resolution planning cycle. Priority areas are “deep dives”

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<sup>24</sup> In general, a complaint to the court does not result in an automatic stay of execution. The court can in specific cases order a stay in accordance with general procedural legislation. The parliamentary explanations to the Resolution Act would guide the court’s interpretation of the Act. They state that it is presumed that in a resolution it is in the public interest that the courts will not issuing a stay of execution in the interest of affected shareholders or creditors. However, this will be a case-by-case decision left to the discretion of the courts.

<sup>25</sup> FSB Key Attributes Assessment Methodology for the Banking Sector, EC 5.6.

<sup>26</sup> The frequency can be higher if, for example, major organizational changes occur.

into certain aspects of the resolution plans which in the authorities' view have not been addressed sufficiently enough in the plans. These areas include, among others: Operational continuity during resolution; internal MREL; identification of key personnel and continuation of management information systems. The authorities have set 2022 as a deadline to finalize the outstanding areas and to have fully fledged resolution plans in place. Procedure wise, FSC prepares the plans and presents them to DFSA for approval. DFSA has to officially consult DN on the resolution plans for Danish SIFIs. The DFSA receives all relevant information from institutions for preparing the resolution plans and shares it with the FSC and the DN.<sup>27</sup> During each planning cycle, institutions have to report data as input for the resolution plans, and the resolution authorities provide feedback on the quality of the data reporting. Institutions receive a short summary of the plan once it is approved by DFSA.<sup>28</sup>

**31. For non-systemic institutions, the resolution plan follows simplified obligations.** For smaller institutions, resolution plans are updated less frequently, in general every two years, unless they are under intensified supervision or have a more significant size (in which case the plans also will contain more information). The FSC and DFSA are in close dialogue on the plans with the FSC drafting the plans and the DFSA approving the plans together. The resolution strategy and main conclusions from the resolution plan are summarized in the MREL decision, which is sent to each institution.

**32. The authorities see the timely and accurate reporting of data for the purpose of resolution as key for any resolution proceeding and ask institutions to develop the capacity to provide financial statements and other relevant data within 12 hours of the request.** DFSA has specified in an EO<sup>29</sup> which information institutions have to deliver for resolution during an actual resolution situation. For this purpose, institutions are required to maintain management information systems and procedures to provide FSC with the required financial statements including assets, debt and other liabilities, a breakdown of deposits for deposit insurance purposes and other necessary information for valuation purposes. A system must also be in place that allows for a write down of uninsured deposits as part of a resolution. FSC can ask an institution as early as when it meets the conditions for early intervention to provide the specified data. Compliance with the requirements for resolution preparedness is part of DFSA's supervisory process and subject through testing by FSC. Since 2017, the FSC and the DFSA have performed annual tests of the Danish institutions ability to deliver relevant data in compliance with the EO. The test is performed with a sample of three institutions each year. For the first time in 2019, a SIFI was included in the sample, and going forward, it is foreseen that one SIFI would be included in the samples each year. Given the

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<sup>27</sup> When an institution enters (or is about to enter resolution) then FSC can ask it to directly report to them.

<sup>28</sup> For systemic groups the summary includes the following: (i) Brief description of the resolution strategy and justification for the preferred strategy; (ii) conclusions on the resolvability assessment; (iii) focus areas for the resolution planning work; and (iv) involvement of resolution college for cross-border banks.

<sup>29</sup> Executive Order on resolution planning and resolution preparedness.

importance of timely and accurate data to implement the Danish resolution strategy, DFSA and FSC should accelerate the testing cycle, aiming to test more than one SIFI a year.

**33. Resolution planning for SIFIs needs to be accelerated and work on the priority areas should be expedited.** In particular, groups including both deposit taking banks and MCIs pose special challenges for resolution, especially because of their operational connectivity. From a business continuity perspective, this would render it difficult to run a failing MCI without the group on a standalone basis if the restructuring of the whole group is not a feasible option. More work is therefore needed regarding the potential use of a bridge MCI to ensure continuity of critical mortgage-related functions, including servicing the mortgages and maintaining the hedging and swap arrangements to match the interest and maturity structure of the bonds with the underlying mortgages.

## C. Resolvability Assessment

**34. As part of the resolution planning process, the resolution authorities prepare annually resolvability assessments for all SIFIs and institutions under intensified supervision.** For smaller institutions, resolvability assessments are made on a biannual basis. The assessments are conducted on a proportionate basis. The resolution authorities prioritize particular areas of the resolvability assessment each year. For the 2019 cycle, the resolution authorities have focused on critical functions, liquidity in resolution, operational continuity and cross-border communication and coordination. The authorities have identified the lack of internal MREL as an impediment to resolvability as it is currently being phased in. Other potential challenges in resolution, which the authorities expect to analyse in more detail in 2020, are the inability of SIFIs to generate the pertinent resolution data within 12 hours; the continuation of critical functions as well as operational interconnectedness within a bank-MCI group. The FBA gives powers to DFSA to address or remove impediments to resolvability. The resolution authorities have not identified any significant impediments so far and therefore DFSA did not have to make use of the powers in the past.

# DEPOSITOR INSURANCE AND RESOLUTION FUNDING

## A. Deposit Insurance

**35. The Danish DIS, the Deposit Guarantee Fund (DGF), is set up within the framework prescribed by the EU DGSD in the form of a paybox plus system.** It covers deposits up to an amount of approximately DKK 745,000 (equivalent to the EU wide harmonized level of EUR 100,000) per depositor and per bank. When calculating the coverage amount, the DIS applies set-off of insured deposits with liabilities due to the failed institution. Insured depositors are natural and legal persons, excluding financial institutions and other sophisticated depositors such as insurance companies, public authorities and pension funds. In addition, the Danish lawmaker has made use of some options provided under the DGSD to extent temporary high coverage to, among others, the full amount of pension savings accounts, deposits that serve social purposes for up to EUR 150,000 and deposits resulting from (non-commercial) real estate transactions up to EUR 10 million. Because

of this additional coverage, which is not implemented in all EU member states, some branches of foreign banks of EU and EEA countries in Denmark which are in general covered by the DIS of their home country have applied for supplementary coverage under the Danish scheme (so called “topping up”).<sup>30</sup> All deposit taking institutions licensed in Denmark are compulsory members.<sup>31</sup> The DGF is performing stress tests which include pay-outs scenarios, funding, and cross-borders issues. It is also required to publish an annual report.

**36. The ex-ante funded DIS appears to be sufficiently funded and has sound backstop in place.** At end-2018, the fund had a size of DKK 8.8 billion (with a target level of 0.8 percent of insured deposits or DKK 4.9 billion) and the fund therefore has stopped raising contributions.<sup>32</sup> The current size is sufficient to cover fully the insured deposits of all but the seven biggest banks (on a single basis), but without taking into account the liabilities towards temporary high balances (see below). The MCI fund is limited to DKK 10 million.<sup>33</sup> The DGF can require extraordinary contributions from its member. It can also make use of the following back-up funding options, which can be executed within a day:

- Take a loan from other compartments of the DGF up to a certain limit;
- Borrow from the market;
- Ask for a state guarantee from MIBFA with approval of the parliament’s Finance Committee;
- Secure state re-lending through FSC.<sup>34</sup>

**37. By law, the DGF can only be invested in low-risk assets.** The fund can keep cash with the central bank. The investment policy that is been approved annually by the FSC’s Board of Directors restricts the portfolio manager to invest only in Danish government bonds and since 2018 (in the light of limited supply from government bonds) DKK nominated non-callable mortgage bonds. Further risk management is done by restricting maturities of investable papers and the overall duration of the portfolio. In addition, the portfolio should hold papers from at least four different issuers with a maximum of 30 percent of an individual paper. The portfolio management is outsourced to an external manager, which makes investment decisions based on restrictions derived from the investment policy. Repo arrangements with commercial banks are in place to ensure immediate liquidity needs can be met. The Guarantee Fund should diversify potential risks stemming

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<sup>30</sup> Currently, 7 branches out of 22 branches operating in Denmark as deposit-taking institutions.

<sup>31</sup> As of 2018, there are 64 banks licensed in Denmark, five banks from the Faroe Islands and Greenland as well as 7 MCIs being full members of the DIS.

<sup>32</sup> FSC assesses annually if the fund still meets the target level. If the size of the fund falls below target level, the collection of contributions would be resumed, and the individual contribution be determined on a risk-based model in line with EBA Guidelines (EBA/GL/2015/10).

<sup>33</sup> MCIs though not allowed by law to accept deposits are mandatory members of the DGF which has a sub-fund of DKK 10 million (fully paid in) for the unlikely event that cash balances held at an MCI at the point of failure would fall under deposit insurance.

<sup>34</sup> Section 74 (4) Resolution Act.

from its investment in mortgage bonds by also investing in alternative assets which are low risk (e.g., Euro-denominated government bonds of selected EU sovereigns).

**38. The DGF has arrangements in place to reimburse depositors within 7 working days after commencement of bankruptcy proceedings, but its Single Customer View (SCV) needs to be expanded to include temporary high balances.** Reimbursement can be either done through direct payments or transfer of deposits to accounts with other banks. No pay-outs have been made during the period 2014-19, since the preferred resolution strategy in Denmark aims at preventing a bankruptcy and the need for a payout. The FSC can request necessary information pertinent for deposit insurance from an institution anytime. For resolution, institutions need to be able to deliver within 12 hours information on the deposit base, including a break-down of the individual types of the insured deposits (SCV). The fulfilment of this obligation is also part of the annual audit. Should the FSC perform pay-outs (for example, on behalf of another EU DIS<sup>35</sup>), the FSC can use the state's collective payments system (Statens Koncern Betalinger, SKB).<sup>36</sup> However, currently not all banks are able to track down and report to FSC all types of temporary high balances in their systems, which can include large amounts when it comes to the full coverage of pension savings accounts. This can complicate a resolution, for example, when deciding about the scope of the bail-in tool as insured deposits are excluded from it. FSC should therefore oblige banks to expand their SCV to include the clear identification of all temporary high balances.

**39. Public awareness levels of the DIS should be regularly assessed.**<sup>37</sup> Depositors in Denmark are informed about the DIS when opening a deposit account and later on an annual basis by their bank. FSC informs via its webpage about the system and has established a hotline for depositors. While there is anecdotal evidence that depositors are aware of the coverage level and the limitations of deposit insurance, FSC should ensure that this understanding is broad, especially since the relatively new coverage of temporary high balances is complex and the Danish resolution strategy aims at preventing a payout.

## B. Resolution Funding

**40. The DGF cannot directly be used to fund resolution measures but might support the use of the bail-in tool.** The DGF will pay an amount corresponding to the amount by which insured deposits would have been written down if they would have been part of the measure and not excluded from a bail-in by law. The DGF's contribution is subject to a least-cost test and the DIS

<sup>35</sup> Under the EU DGSD, the DGF is also obliged to pay out deposits of foreign EU branches in Denmark on behalf of and funded by their home DIS and other EU DISs would be obliged to pay out the deposits of Danish branches abroad insured by DGF. To facilitate this process, FSC has become a member of the EFDI MOU which provides for sharing of depositor data between the EU DISs.

<sup>36</sup> The SKB-system is a central payment system facilitating deposits and payments for both the governmental institutions as well as all independent governmental institutions. This governmental mass-payment system is tested, robust and used on a continuously basis (daily) for a high number of payments.

<sup>37</sup> IADI Core Principle 10, Essential Criteria 7: "The deposit insurer monitors, on an ongoing basis, its public awareness activities and arranges, on a periodic basis, independent evaluations of the effectiveness of its public awareness programme or activities."



would benefit from the NCWOL-principle and therefore receive compensation from the Resolution Fund if the final valuation would determine that it suffered bigger losses than it would have in bankruptcy. The DIS enjoys super preference in the creditor hierarchy after being subrogated to the claims of insured depositors. In bankruptcy proceedings, claims from the DGF are paid immediately after duties and costs of the bankruptcy proceedings.

**41. Banks, MCIs and investment companies operating in Denmark are contributing to the Resolution Fund through an annual levy which is risk-adjusted for large institutions.** The fund has a target level of 1 percent of insured deposits (or DKK 6.1 billion) which must be met by 2024. As of end 2018, the Resolution Fund accounted for DKK 2.4 billion. FSC is managing the separate resolution fund which was enacted in June 2015. The investment strategy for the resolution fund is identical with the one for the DGF and foresees an investment in low-risk assets (see paragraph 37). The FSC has a preapproved EU state aid scheme for financial institutions with a balance sheet below Euro 3 billion in place and can therefore use funds from the Resolution Fund without further approval from the EU. For resolution of larger institutions (currently 11 institutions, including the seven SIFIs), FSC would need state-aid approval from the European Commission if the fund is involved.

**42. The resolution fund may be used, among others, to:**

- Guarantee the assets and liabilities of or provide loans to institutions under resolution, its subsidiaries, a bridge institution or an asset management vehicle;
- Purchase assets of the institution under resolution;
- Make capital injections and provide liquidity to a bridge institution and an asset management vehicle set up for resolution purposes;
- Pay compensation to shareholders or creditors if the NCWOL-principle has been breached; and
- Provide loans to the resolution funding arrangements of other countries, subject to ministerial approval.

**43. Sufficient back-up funding arrangements exist for the resolution fund.** The fund can raise extraordinary contributions (maximum of three times the annual contribution) and borrow from the market to cover a shortfall. It can also take loans from Bank Package I-V (FSC equity)<sup>38</sup> and, subject to ministerial approval, borrow from other EU resolution funding arrangements. It has, through the FSC, access to a full backstop liquidity arrangement (state re-lending) which could be

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<sup>38</sup> As of end of 2018, the Bank Package I-V activities accounted for DKK 6.8 billion which would be sufficient to boost the size of the Resolution Fund to its target level.

provided within a day without parliamentary approval.<sup>39</sup> Re-lending would be on market terms and paid back over time with the industry's contributions to the Resolution Fund.

## OFFICIAL FINANCIAL SUPPORT (INCLUDING LIQUIDITY ASSISTANCE IN RESOLUTION)

### A. Official Financial Support

**44. Denmark has implemented in its law the BRRD's optional government stabilization tools.**<sup>40</sup> In extraordinary circumstances, the state may participate in the resolution of an institution when the use of other resolution tools would not suffice to avoid significant adverse effects on financial stability or the public interest. The tool allows the government to provide capital contributions or to temporarily acquire the institution through a company established by FSC. The tool may only be applied when the Minister for Industry, Business, and Financial Affairs assesses the conditions for the use of the stabilization tool have been met and when the parliament's Finance Committee has approved the application. The Minister will base his decision upon a recommendation of FSC and after consulting with DFSA and DN. FSC would then implement the decision on behalf of the state. The use of the tool is subject to the mandatory 8 percent contribution to loss absorption by the institution's shareholders and creditors and also to the EU state aid rules.

**45. Beyond this, the framework does not explicitly establish arrangements for exceptional financial or system-wide support.** Such support would be discussed within the Coordination Committee on Financial and would be subject to final approval by the Danish Parliament. Crisis funding would be available only as a last resort and on the condition that it is paid back by the industry (as exercised during the last financial crisis through the Bank Packages).

### B. Liquidity Assistance in Resolution

**46. The critical issue of liquidity support in resolution warrants further consideration.** The Danish authorities acknowledge the importance of having procedures in place but are following the EU discussions on the topic while exploring different options internally (liquidity provided through ELA, the Resolution Fund with government back-up or the government directly). DN may—but is not obliged to—grant emergency liquidity assistance (ELA) to solvent credit institutions (banks and MCIs) that have a temporary need for liquidity and that are no longer able to refinance their

<sup>39</sup> Art. 74 (4) Resolution Act. Out of courtesy, the government might consider informing the parliament (Finance Committee) on the matter out, provided there is sufficient time. There are arrangements in place to ensure confidentiality of such information process.

<sup>40</sup> Section 51 Resolution Act.

operations on the market and have sufficient collateral.<sup>41</sup> A central bank should be able to provide liquidity, subject to safeguards, to an institution, but which is considered systemic and viable and whose solvency concerns will be resolved with certainty in the context of a realistic, time-bound resolution plan which will shortly be implemented.<sup>42</sup> The resolution and/or supervisory authority should make a positive determination of viability. It should then be up to the central bank to decide on liquidity provision, which should be backed by an indemnity from the government. Many central banks are currently unable to provide liquidity in such circumstances, typically because of definitions of solvency and licensing conditions, although progress is being made in some jurisdictions.<sup>43</sup> While, under the BRRD, resolution planning cannot assume that ELA will be available, in an actual resolution, it cannot be ruled out—and should be reflected in the resolution scheme as necessary—that, notably, bailed-in entities may need significant liquidity to preserve confidence in the immediate aftermath of a crisis. In Denmark this liquidity could be provided either through access to ELA from DN (with a government guarantee) or liquidity—through lending or guarantees—from the Resolution Fund (with back-up funding from the government), depending which option is better suited to secure the needed amounts within a short period of time and on a continuous basis.

## CONTINGENCY PLANNING AND CRISIS MANAGEMENT

### A. Domestic Arrangements and Cooperation

**47. The Coordination Committee on Financial Stability exists since 2005 but has become less active in its recent past.**<sup>44</sup> The Coordination Committee consists of representatives from the MIBFA and the MOF (both Deputy Minister level), the DFSA (Director General) and DN (one of the three governors). In the past, representatives of the Prime Minister's Office and the FSC often participated in the meetings by invitation. An MOU from 2005 governs the collaboration between the four institutions through the collection and exchange of information on matters related to financial stability, consultation on amendments of relevant laws or regulations, cooperation on international issues, and coordination when handling the failure of a SIFI or a financial crisis, including extraordinary public funding. The MIBFA chairs the committee and prepares the meetings.

<sup>41</sup> ELA is covered in detail in the 2020 FSAP in a separate TN on liquidity.

<sup>42</sup> The Agreement on Emergency Liquidity Assistance of the Eurosystem from May 17, 2017 introduced an alternative to meet the solvency test “a credible prospect of recapitalization...by which harmonized minimum regulatory capital levels would be restored within 24 weeks...; in duly justified, exceptional cases the Governing Council may decide to prolong the grace period of 24 weeks.” Arguably, a bank that is subject to recovery or resolution measures would have a “credible prospect of recapitalization”.

<sup>43</sup> The Hong Kong authorities announced a new Resolution Facility in August 2019, available to a bank placed into resolution, with any losses being recoverable from the industry via a levy. An example for ELA for a bank in resolution is the Canadian framework which can be found here: <https://www.bankofcanada.ca/markets/market-operations-liquidity-provision/framework-market-operations-liquidity-provision/emergency-lending-assistance/>

<sup>44</sup> MOU concerning financial supervision between DN, MOF, MIBFA and DFSA (April 2005).

It meets at least every six months and otherwise as required. In the recent past, the Coordination Committee discussed the new resolution framework (BRRD transposition) and MREL requirements. At the time of the FSAP mission, the Committee currently had a subcommittee analyzing whether Denmark should participate in the EU Banking Union.<sup>45</sup>

**48. The role of the Coordination Committee should be enhanced through making FSC an official member and engaging in systemwide contingency planning and crisis preparedness.**

Since the MOU was established in 2005, FSC has been created and morphed into the role of one of the resolution authorities and the responsible entity for the DIS<sup>46</sup> and the Resolution Fund. FSC is therefore an important member of the safety net, representing two of its pillars, and should become an official member of a revised MOU and an extended Coordination Committee. While individual contingency plans and testing of procedures are in place with DFSA, DN and FSC, the safety net is lacking a systemwide plan. For example, FSC has developed different contingency scenarios, including how to deal with a situation where a failing institution has not sufficient loss-absorption capacity, DN has tested its ELA facility and DFSA has spelled out its reaction to a breach of MREL requirements. Contingency planning and business continuity efforts undertaken by the different agencies need to be coordinated and synchronized in an overarching national crisis management plan to ensure complementarity. The plan should be prepared and regularly updated by the Coordination Committee. As part of the plan, the authorities should prepare a crisis communication plan, that the agencies speak with “one voice” during the crisis thereby using the same facts and assumptions. In the mid-term, the authorities should make use of simulation exercises (which are already foreseen under the MOU) to test and enhance the plan. Currently, early steps towards a common crisis plan and communication are undertaken within the safety net.

## B. Cross-border Arrangements and Cooperation

**49. Since 2016, resolution colleges are in place and operational for three banks: Danske Bank, Jyske Bank<sup>47</sup> and Saxo Bank.** Chaired by DFSA and FSC as group-level resolution authorities, the colleges involve the relevant host authorities and the parties have entered into cooperation agreements detailing the work of the colleges. In addition, the authorities participate in Swedish resolution colleges (including SEB and Handelsbanken) and SRB resolution colleges for Nordea and BNP Parisbas. DN, MOF and MIBFA participate in some of the colleges as observers. In addition, FSC participates in the Swedbank resolution college in its capacity as DGS authority. The resolution colleges discuss group recovery plans and group resolvability and sign joint decisions on resolution

<sup>45</sup> The Committee finalized the analysis and published a report on the matter in December 2019.

<sup>46</sup> IADI Core Principle 6, Essential Criteria 3.

<sup>47</sup> With the sale of the subsidiary in Gibraltar, the resolution college for Jyske Bank will be dissolved (expected for 2020).

plans and MREL.<sup>48</sup> Authorities are permitted and able to exchange pertinent information within the colleges and on a bilateral basis; meetings occur during the year on both terms.

**50. Nordic and Baltic authorities have revived the Nordic Baltic Stability Group (NBSG) through signing a new cross-border cooperation agreement in 2018, thereby enhancing the earlier 2010 MOU.**<sup>49</sup> The original group of central banks, relevant ministries, and supervisors has been expanded to include newly formed resolution authorities. The complete Danish safety net participates in the NBSG. The objective of the MOU is to facilitate cooperation and coordination in dealing with a cross-border systemic crisis in order to promote financial stability in the region. The NBSG meets regularly, at least annually, but can meet more often under extraordinary circumstances. Relevant authorities from the EU (ECB and SRB, for example) can be invited as guests. Tasks of the NBSG, among others, are the exchange of information (especially during times of market turbulence), coordination of public statements, organization of regular financial crisis simulation exercises, as well as the enhancement of crisis preparedness. A separate MOU between the central banks of the region from 2016 has established procedures for cooperation in granting ELA to a cross-border group.<sup>50</sup>

**51. In 2019, the Danish safety net participated in a Nordic-Baltic financial crisis simulation, developed and organized by the NBSG.** The exercise involved 31 authorities from the region, the SRB and the EU Commission (with the ECB as an observer). It tested the authorities' crisis management capabilities, regional cooperation and crisis communication. The simulation revealed, among others, that in the absence of internal MREL, the SPOE strategy is not fully operational and issues with funding in resolution, timely valuation, bank data, as well as challenges to coordinate resolution actions (bail-in) and a joint crisis communication. The exercise was seen as extremely helpful by all Danish authorities as it also helped to assess internal coordination in Denmark, especially since a large (fictitious) Danish bank was part of the simulation. As a follow-up, the NBSG set up a working group on (secure) communication channels to be used during a crisis.

**52. The legal framework facilitates DFSA and FSC to cooperate broadly with foreign resolution authorities.** The FSC will take the other countries' interest into considerations when dealing with a Danish cross-border institution. When a foreign resolution authority applies resolution actions against an institution, an entity or a branch, the FSC will to the extent necessary provide assistance by ensuring write-downs, conversions or the transfer of instruments of ownership or assets, rights or liabilities located in Denmark or by assessing whether the resolution proceedings of the foreign resolution authority can be recognized and enforced. Such recognition and enforcement will be coordinated in the resolution colleges.

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<sup>48</sup> The group resolution plan for Saxo Bank is in the process of being updated due to a recent material change in the group structure.

<sup>49</sup> Signatories are the following jurisdictions: Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden.

<sup>50</sup> Participants of the MOU are Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden.

## LEGAL PROTECTION

**53. Staff of the safety net authorities enjoy sufficient legal protection under the Danish Act of 1683.** In general, only the employer (whether it is a public or private entity) is liable for actions taken by management and staff when discharging their duties as long as these actions are within the scope of those duties. Present and former employees are therefore not personally liable for the actions made in the usual and proper exercise of their duties and functions. Only behavior which is outside the function (e.g. criminal behavior) would allow to directly sue a staff member. The courts would automatically dismiss any legal claims against employees.

**54. Current and former members of management and the Board of Directors of the FSC are protected through a two-tier system.** FSC has secured insurance for the Board and management with regard to both legal representation and liabilities. The insurance currently covers up to EUR 90 million with a cap on legal representation expenses of EUR 3.35 million. Advisors have separate liability insurances that vary in coverage. The MIBFA has waived any right to claim damages, including a right of recourse from the members of Board and management for damages which exceed the insurance coverage, if the member is only guilty of ordinary negligence. Members of the Board of Directors of DFSA are protected through the general governmental self-insurance for their duties carried out for DFSA.

## Appendix I. Danish Resolution Cases: J.A.K. Slagelse and Københavns Andelskasse

**1. The FSC has twice used its revised resolution power and tools and therefore tested the new resolution framework from 2015.** Both resolutions were rather small institutions in the form of cooperative banks with total deposits under USD 50 million which were wound down in line with Denmark's preferred resolution strategy after they passed the public interest test (required under Art. 32 (5) BRRD). The FSC determined that resolution instead of bankruptcy was in the public interest because of depositors' need to access their deposits and the payment system (as most daily payments in Denmark are made through electronic transfers) without any interruptions.

**2. In October 2015, the DFSA determined after recovery measures had been unsuccessful that the J.A.K. Slagelse was failing or likely to fail because of a lack of capital.** The cooperative had less than 4,000 depositors with total deposits below DKK 250 million (USD 36 million). FSC implemented the following resolution measures: It exercised control over the bank and replaced its Board of Directors and management with its own staff. FSC then created a new subsidiary in form of a bridge bank holding, Broinstitut ("bridge institution") I A/S, which assumed ownership of the cooperative. The bank remained open to the public and services were not interrupted, but immediately steps were undertaken by FSC with a view to wind down the activities. Since the cooperative had total assets of less than EUR 3 billion, its resolution was pre-approved under the EU state aid regime and the EU Commission only needed to be informed by FSC.

**3. Based on the provisional valuation done by FSC and before the transfer to the bridge, all cooperative members', subordinated creditors' and ordinary unsecured creditors' claims were written down entirely.** The Danish DIS had to contribute to the losses instead of protected depositors who are in general excluded from a bail-in. New capital from the Resolution Fund was injected after the bail-in. All resolution measures were implemented within a day (takeover of management, set-up of bridge bank holding and execution of bail-in). The mandatory ex-post valuation confirmed the provisional valuation and FSC declared the interim haircuts as final.

**4. FSC concentrated on winding down the activities which required a banking license first, after which it could hand back the license in May 2017.** An open bidding process for a sale of the full institution was unsuccessfully undertaken in 2016. Currently, FSC is dealing with the remaining assets of the failed institution.

**5. In September 2018, the FSA determined that Københavns Andelskasse was failing or likely to fail.** The determination was made on the basis of an on-site inspection which revealed a significant breach of financial regulation as well as an unsustainable business model. At the point of failure, the cooperative had around 1,940 depositors with deposits in the amount of DKK 311 million (around EUR 46 million). FSC saw the conditions for resolution fulfilled on the same grounds as with J.A.K. Slagelse (public's interest in the continuity of deposit and payment functions). The resolution strategy followed the agreed approach (bail-in, assuming control of management, transferring the

ownership of the institution under a new subsidiary in form of a bridge bank holding, Broinstitut II A/S). The resolution was covered under the pre-approved EU state aid scheme.

**6. In the interest of time, FSC made a temporary financial valuation of the cooperative in order to determine the amount of losses.** On the basis of this valuation, the contributed capital of members was cancelled, and subordinated creditors and unsecured creditors, including uninsured depositors and insured depositors with deposits above the deposit insurance level (EUR 100.000) saw their claims written down (bail-in). After the resolution the bridge bank holding became the only member of the cooperative. New capital was injected after the bail-in from the Resolution Fund. The final valuation by an independent auditor is still outstanding which will enable FSC to finalize the provisional write-downs. The banking license was revoked in June 2019 after banking activities requiring a licence have been terminated. Remaining assets are being wound down by FSC (for example, sale of loan portfolios or internal work out) in a controlled liquidation.