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The Systemic Risk Council
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PRESS RELEASE

MEETING OF THE SYSTEMIC RISK COUNCIL

The Systemic Risk Council has held its fourteenth meeting. Sudden changes in risk perception in the financial markets may still lead to significant falls in asset prices and fire sales. Prices of owner-occupied flats are close to the peak in 2006.

There may be systemic risks associated with a sudden change in risk perception in the financial markets

Interest rates are still expected to remain very low for a long time. A sudden rise in the currently low risk premia, combined with low market liquidity, may lead to substantial falls in asset prices and fire sales.

In the short term, there is considerable focus on the UK referendum on membership of the EU. The direct exposures of Danish financial institutions to the UK are relatively limited, but any market turmoil in the wake of the referendum could have an indirect impact on the Danish financial sector.

Prices of owner occupied flats are close to the 2006 peak

Subdued demand for credit and low interest margins entail a risk of loose credit standards for new lending. This applies especially in areas where property prices are rising.

Prices of owner occupied flats adjusted for inflation are close to the 2006 peak levels, which proved to be unsustainable, and the development on the market for cooperative flats is also cause for concern. Price increases may continue in the coming years in light of the current long-term outlook of low interest rates coupled with an underlying increase in real incomes. Surges in property prices increase the risk of a subsequent significant downturn in prices, caused for example by an interest rate increase, and might have a systemic impact.

The Council will discuss at its next meeting what further initiatives that could be relevant in case property price increases persist and when such initiatives should be introduced. The Council expects to initiate a public hearing related to the subject.

Other topics discussed by the Council

At the meeting, the Council also discussed a range of other topics, including:

- The level of the countercyclical capital buffer rate in Denmark. The Council still considers a rate of 0 per cent to be appropriate.

- The countercyclical capital buffer in Greenland where legislation on the buffer also has entered into force. The Council advises – based inter alia on information from Greenland's authorities – that the Minister for Business and Growth sets the capital buffer rate for Greenland at 0 per cent.
- The high degree of interconnectedness between mortgage banks and other banks, due to the credit institutions' large portfolios of mortgage bonds. The Council finds that it could have systemic consequences if some of the Danish mortgage bonds no longer meet the criteria for being classified as covered bonds, SDO's. The credit institutions own one fourth of the outstanding mortgage bonds, which total approximately kr. 3,000 billion in value. A loss of the SDO classification could trigger a fire sale by credit institutions, resulting in losses for the institutions themselves and for other investors. The Council assesses the probability of a loss of the SDO classification to be low at present, but it will increase in case property prices fall.
- The new International Financial Reporting Standard, IFRS 9, which is expected to come into force on 1 January 2018. The Council finds it important to preserve a high degree of credibility in the financial reporting of Danish banks when implementing the new standard. The standard lays down new principles for impairment measurement of financial assets. Experience from the financial crisis shows that there may be a need to specify the international standards in more detail in order to avoid diverse interpretations. Diverse interpretations may lead to considerable uncertainty about the actual financial position of individual institutions, as seen in the case of some institutions prior to the introduction of the present Annex 10 to the Danish Generally Accepted Accounting Principles, GAAP, for credit institutions. If shareholders and creditors lose confidence in the financial position of institutions, the opportunities for institutions to raise capital and funding deteriorate. The Council considers it to be desirable if the FSA, as soon as possible, finalizes the foundation for the implementation of IFRS 9 by institutions, thereby offering them the best possible conditions for preparing the implementation.
- Cyber risk and resilience. The Council has held a seminar on this topic with the participation of a wide range of financial sector representatives. Following the seminar, a sector forum for operational resilience, including cyber resilience, has been established. The forum will support knowledge-sharing and collaboration across the sector, e.g. by initiating cross-sector tests of operational contingency plans. Key sector representatives and authorities participate in this forum.[1]

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[1] See Danmarks Nationalbank, Financial stability, 1st half 2016, Chapter 5 for further information about the sector forum.