DET SYSTEMISKE RISIKORÅD

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PRESS RELEASE

The Systemic Risk Council
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MEETING OF THE SYSTEMIC RISK COUNCIL

The Systemic Risk Council recommends that the Minister for Industry, Business and Financial Affairs increase the countercyclical capital buffer from 1.5 per cent to 2.0 per cent from 30 December 2020. Unless the build-up of risks in the financial system slows down considerably, the Council expects to recommend a further increase of the buffer rate in the 1st quarter of 2020. It is still the assessment of the Council, which has held its 27th meeting, that risks are building up in the Danish financial system and that the conditions for a further build-up of risks still exist. The countercyclical capital buffer should be built up before stress occurs in the financial system.

Continued build-up of systemic financial risks in Denmark
The Danish economy is still in an upswing, and financial conditions are generally accommodative. Yields on Danish government and mortgage bonds have fallen to a historically low level. All Danish government bond yields are now negative, and market participants expect the Danish money market interest rate to remain negative for many years to come. To compensate for the low expected returns, financial companies have for some time been assuming greater risks in the form of more risky investments. The very low interest rates have also resulted in low required returns in the commercial real estate market, which supports a high price level. Given that monetary policy is set to remain accommodative, this development in property prices and risk appetite can be expected to continue.

Lending by credit institutions still shows signs of risk build-up, although overall credit growth is moderate. Driven by intensified competition for customers, some banks have eased corporate credit standards for a relatively long period of time. This is reflected in e.g. low interest rates on new loans.The long period of low interest rates and accommodative financial conditions combined with the economic upswing provides a basis for further build-up of credit risk. Risks are amplified by the already high level of total credit.

The Council recommends that the countercyclical capital buffer rate be increased to 2.0 per cent
Against the background of financial developments, the Council recommends that the Minister for Industry, Business and Financial Affairs increase the countercyclical capital buffer from 1.5 per cent to 2.0 per cent from 30 December 2020. Unless the build-up of risks in the financial system slows down considerably, the Council expects to recommend a further increase of the buffer rate by 0.5 percentage point, to 2.5 per cent, in the 1st quarter of 2020. The Minister for Industry, Business and Financial Affairs has complied with the Council's recommendation from March 2019 to increase the countercyclical capital buffer to 1.5 per cent from 30 June 2020.

In mid-2019, the vast majority of Danish institutions had sufficient capital to meet a countercyclical capital buffer requirement of 2.0 per cent. In general, bank earnings are high, albeit falling, and can be used to build up further capital.

The Council is ready to recommend a reduction of the buffer rate with immediate effect if substantial stress occurs in the financial system. Release of the buffer can help to limit the negative effects on the real economy in case there is a risk of severe tightening of lending to households and firms.

The Council's assessment of risks in the housing market
The Council was informed about the European Systemic Risk Board's, ESRB, recommendation to the Danish government to further address the build-up of risk in the housing market issued in September 2019. The ESRB has analysed the build-up of risk in the Danish housing market, and its assessment is that the measures taken by the Danish authorities are "fully appropriate" but only "partially sufficient". Consequently, the ESRB recommends, inter alia, higher capital requirements and possibly further tightening of the guidelines for housing loans should there be indications of further build-up of risk in the housing market.

House prices have flattened over the past year. Especially for owner-occupied flats in the Copenhagen area, growth in both prices and activity has slowed down, but price levels remain high. Among first-time buyers and multi-time buyers, the share of new loans with high LTI and LTV ratios has remained largely unchanged. At the same time, mortgage loans are increasingly at fixed interest rates and/or with amortisation and thus less risky. The Council finds it positive that the recent measures on mortgage financing have contributed to curbing the build-up of risks from new loans.

Other issues
The Council discussed whether the future minimum requirement for the credit institutions' leverage ratio will necessitate measures to secure the capital buffers as they are intended. The leverage ratio is an expression of the ratio between an institution's capital and assets. The minimum requirement enters into force in 2021 and means that some systemic groups will not be able to fully use their capital buffers to absorb losses before they reach the minimum leverage requirement. The Council decided to await the European Commission's report on whether it is advisable to introduce a requirement for a leverage ratio buffer for national SIFIs in 2020.

The Council discussed the framework for restructuring of SIFI's, including mortgage credit institutions, following up its discussions in March 2019. Mortgage credit institutions are exempt from having to meet a minimum requirement for own funds and eligible liabilities, MREL. Instead, they must observe a debt buffer requirement. The Council discussed how being subject to a debt buffer requirement rather than an MREL will affect the framework for restructuring of a mortgage credit institution. The Financial Stability Company participated in this discussion.

The Council discussed subordination requirements for Danish SIFIs in connection with resolution. Subordination entails that capital and debt instruments for meeting the institutions' MREL bear losses before unsecured creditors in a resolution situation. The forthcoming Bank Recovery and Resolution Directive, BRRD II, includes a framework for national authorities' possibilities of requiring subordination. Subordination helps to ensure a clear legal framework and transparency as regards the funds that will bear losses and that are available for recapitalisation of an institution in a resolution situation. Hence, the Council finds that a requirement for subordination of MREL funds is important for ensuring that the resolution strategies for the Danish SIFIs can be implemented and are credible.

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