DET SYSTEMISKE
RISIKORÅD

RECOMMENDATION

June 24, 2013

PHASING-IN OF CAPITAL REQUIREMENTS LEGISLATION IN DENMARK[1]

The Systemic Risk Council (the Council) recommends the government to put forward legislative proposals that implement the recommendations of the Committee on Systemically Important Financial Institutions (SIFIs).

Furthermore, the Council recommends the government to put forward legislative proposals on implementing the capital and liquidity requirements in the forthcoming European capital requirements legislation (CRR/CRD IV) in accordance with the timeframe proposed in CRR/CRD IV, with three exceptions:

- Identification criteria and liquidity requirements for SIFIs should be introduced from 2014 and 2014-15, respectively.
- Existing requirements in Denmark should be maintained during a transitional period in cases where the implementation period in CRR/CRD IV implies less stringent requirements than the existing Danish legislation.
- The framework for the countercyclical capital buffer should be introduced from January 1, 2015.

The government is required, within a period of three months, to either comply with the recommendation or to present a statement explaining and justifying why the recommendation has not been complied with.

Explanatory statement

SIFIs are characterized by the fact that their activities are of such a size or nature, that difficulties for an individual institute could have a detrimental impact on the entire economy. The Committee on Systemically Important Financial Institutions (the SIFI Committee) has put forward recommendations on, inter alia, identification criteria for Danish SIFIs and the necessary safeguards that Danish SIFIs should uphold in order to avoid becoming distressed, including gradually stricter capital requirements. These measures would reduce the risk of financial crises and the related serious economic consequences for society. The capital requirements are in line with the level in other countries with a comparable financial sector and with systemic credit institutions of comparable sizes to the Danish ones, c.f. the SIFI report[2]. Most of the institutions, which according to the SIFI Committee's criteria will be identified as Danish SIFIs, already meet the recommended SIFI capital buffer, and the Council expects that those institutions will continue to do so until it has been fully implemented. The SIFI capital buffer can presumably be implemented within the framework of CRR/CRD IV by using the systemic risk buffer. In addition to the SIFI capital buffer, the SIFI Committee also recommends the establishment of a SIFI crisis management buffer from 2020-2022. The setting of SIFI identification criteria in 2014 will be earlier than what is proposed in CRD IV.

[1] Unofficial translation.

[2] Link to the SIFI report: http://www.evm.dk/english/news/2013/14-03-13-sifi-committee-recommends-additional-requirements.

Access to financing during stressed market conditions may be central for the credit institutions' chances of survival. This motivates an early introduction of financing requirements for SIFIs. The SIFI Committee's recommendation on full implementation of the short-term international liquidity coverage ratio (LCR) for SIFIs from 2015 is within the framework of the CRR. Similar requirements have already been introduced in Sweden. The institutions, which according to the SIFI Committee's criteria will be identified as Danish SIFIs, broadly meet the requirements.[3] A common European requirement for stable long term funding has yet to be determined in the forthcoming European legislation on capital requirements. It is, however, possible to introduce the SIFI Committee's recommended requirements for stable funding at the national level.

CRR/CRD IV outline a gradual implementation of some of the regulatory capital requirements, which all credit institutions shall fulfill in the future, however with some possibility for earlier implementation at the national level. In a Danish context, adhering to the proposal for a gradual implementation is considered the most appropriate approach, as a general rule. Even though the majority of Danish financial institutions currently hold a sufficient level of capital to meet the requirements, many institutions will want an adequate level of excess capital consisting of Common Equity Tier 1 capital. Furthermore, many institutions will need to replace existing issuances with new issuances that meet the new criteria for subordinated capital.

An early implementation of the framework for the countercyclical capital buffer will make it possible to use the entire buffer, in case credit growth and the broader economy develop in a way that would warrant its activation. It is nevertheless only the framework for the buffer that will be implemented in full. At the actual entry into force, the buffer could thus be set to zero.

A gradual implementation of the short term liquidity requirements could in some cases lead to an actual temporary relaxation of the existing liquidity requirements for certain institutions. This would not be advisable, and can be countered by maintaining the existing liquidity requirement during a transitional period.

Lars Rohde, Chairman of the Systemic Risk Council

Statement by the government representatives in the Council[4]

The representatives from the Ministry of Business and Growth, the Ministry of Economic Affairs and the Interior and the Ministry of Finance generally support the Council's recommendation on the implementation of the SIFI Committee's recommendations and the revised Capital Requirements Directive (CRR/CRD IV).

As regards the implementation of the SIFI Committee's recommendations, the representatives note that a legislative proposal cannot be put forward before the on-going political negotiations on an agreement on SIFI regulation in Denmark are completed. It is therefore not certain that a legislative proposal can be put forward within three months.

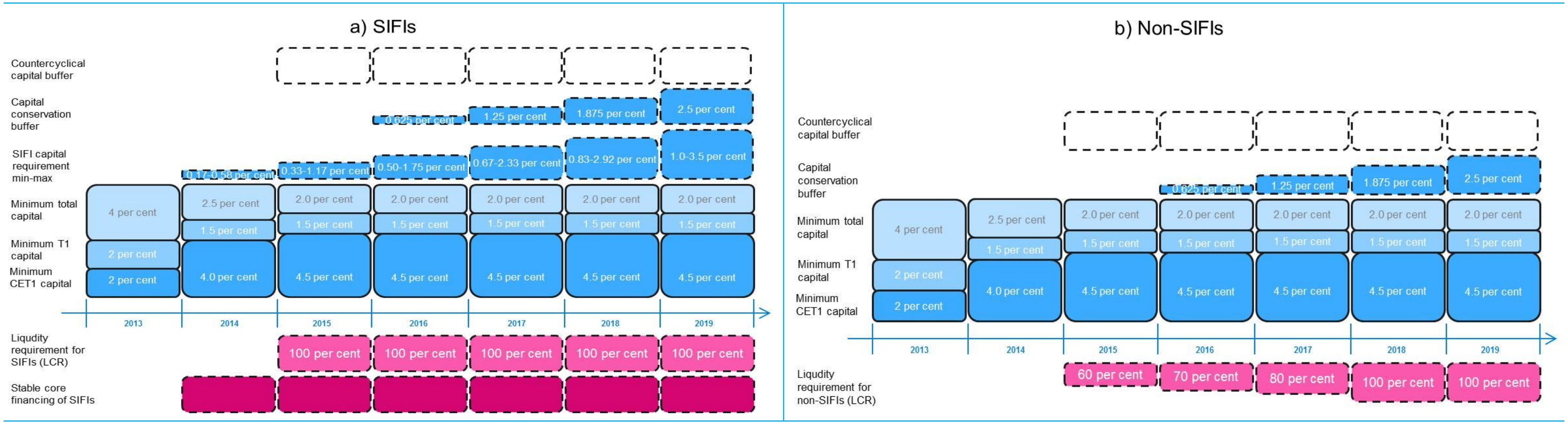
3 The Council assumes that the most liquid mortgage bonds not issued by the institute itself will be counted among the most liquid assets.

4 Recommendations addressed to the government should include a statement from the ministries' representatives in the Council. The ministries' representatives and the members from the Danish Financial Services Authority do not have voting rights in relation to recommendations addressed to the government.

As regards the implementation of CRR/CRD IV, the government representatives note that the plans are for a legislative proposal to be put forward in November. The representatives agree with the recommendation that CRR/CRD IV should be implemented gradually and as a general rule in accordance with the proposed timeframe for CRR/CRD IV. The representatives also agree that an earlier implementation in Denmark of the three specific cases mentioned in the recommendation would be appropriate.

Annex

Overview of the Council's recommendation on the phasing-in of capital and liquidity requirements



Note: Blue indicates different types of capital requirements in percentage of risk-weighted assets. The liquidity requirement is a requirement that liquid assets are able to cover the liquidity need during 30 days of stressed market conditions. The solid lines indicate minimum requirements while the dashed lines indicate buffer requirements, which under certain circumstances may be exceeded. It is only the framework for the countercyclical capital buffer that will be implemented in full. This buffer can thus specifically be set to zero when it enters into force, unless credit growth and the broader economy develop in a way that would warrant its activation. The SIFI Committee has in addition to the recommended SIFI capital requirement recommended the establishment of a crisis management buffer at 5 per cent of the risk-weighted assets, to be phased-in from 2020 to 2022. For non-SIFIs the exiting liquidity requirements should be maintained in a transitional period as a complement to the LCR in the phasing-in period. In the figure, it is assumed that the implementation of CRR/CRD IV will enter into force in Denmark on January 1, 2014.