

MEMORANDUM

3 January 2024

Statement on inspection at Realkredit Danmark A/S

1. Introduction

In March 2023, the Danish Financial Supervisory Authority (the Danish FSA) conducted an inspection at Realkredit Danmark A/S (RD).

The inspection comprised a review of the credit area (loans with long-term interest-only periods) and the valuation area.

2. Summary and risk assessment

During the inspection, RD's relevant policies, guidelines, standard operating procedures and reporting in the two areas were reviewed.

The Danish FSA reviewed 49 selected exposures (loans with long-term interest-only periods). The Danish FSA also reviewed a sample of 100 valuation reports in the urban industry area. Of these, 20 properties were selected for physical inspection. The inspections were made in May 2023.

The purpose of the inspection of the credit area was to examine RD's long-term interest-only lending (FlexLife) with a focus on the institution's requirements and procedures for approving such loans.

RD's Board of Directors has not established a framework for the institution's approval of long-term interest-only loans. The product has an inherent risk, which means that the Board of Directors must establish a framework for the use and customer segments of the product. An order was issued to RD in this respect.

A large part of the institution's FlexLife exposures are equity release loans. RD has not sufficiently specified and defined the situations in which the institution may derogate from the rule stipulating that the borrower must be eligible for a fixed-rate loan with principal repayments.

Equity release loans may generally only warrant derogation from section 21(1) of the Danish Executive Order on Good Practice in Mortgage Credit in regard to customers who have been living in their current home for several years, have a low LTV ratio and would like to continue living in their home for some years yet. These customers have the possibility of using their assets (equity release) by taking out a loan secured on the home at a maximum of 60% of the value of the home with a view to using the loan proceeds to supplement the borrower's amount available for consumption for a fixed number of years. The home is subsequently to be sold.

Even if the LTV ratio is 60% or less, equity release purposes in connection with the purchase of a new home cannot warrant derogation from the general rule that the borrower must be eligible for a fixed-rate loan with principal repayments set out in section 21(1) of the Danish Executive Order on Good Practice in Mortgage Credit. These customers are therefore subject to credit assessment to determine whether the amount available for consumption is sufficient under conventional financing. However, there may be special cases in which equity release purposes in connection with a loan for the purchase of a new home may nevertheless warrant derogation from the general rule set out in section 21(1). This may be the case if a borrower is able to buy a home with cash but decides to take out a loan at 40% of the value of the home.

RD's requirements for the customer's finances for the purposes of approving an equity release loan do not compensate sufficiently for the lack of requirements for the amount available for consumption, which is a characteristic of equity release loans. The entails that the decision to approve the loan is excessively based on the value of the collateral. Orders have been issued to RD in respect of the two matters.

The inadequacies identified in the institution's credit policy and the lack of requirements for the customer's financial situation in connection with equity release loans as well as the extensive use of FlexLife loans, including with equity release, entail an increased risk. The Danish FSA has provided risk information to RD stating that RD should be better at containing and managing risk. RD must take a random sample of exposures within the area in order to assess whether the institution has allocated sufficient capital to cover the increased risk associated with this lending segment.

In the valuation area, the Danish FSA found that, for five properties, the valuations were too high. RD has been ordered to rectify the matters.