

## **MEMORANDUM**

### **The Danish Financial Supervisory Authority**

31 August 2018

## **Statement on inspection of Danske Bank A/S (loans for purchases of owner-occupied homes in growth regions)**

### **Introduction**

In February and March 2018, the Danish Financial Supervisory Authority (the FSA) conducted an inspection of Danske Bank's approvals of new loans for Danish personal customers' purchases of owner-occupied homes in growth regions. The inspection formed part of a themed review of approvals made by six large banks in the second and third quarters of 2017.

The competition for home finance customers has been strong in recent years. One effect has been an increase in the risk appetite of financial institutions. This is reflected in the fact that the banks, in a number of cases, approve loans for customers with a small amount available for consumption, a high debt-to-income ratio or negative net assets.

The main purpose of the inspection was to assess Danske Bank's risk appetite in relation to granting loans for customers' purchases of owner-occupied homes in growth regions. For that purpose, the FSA investigated whether the bank's approvals were in compliance with the "Guidelines on prudent credit assessment in relation to the approval of home loans in growth regions etc." (the growth guidelines). The guidelines were issued in January 2016. The FSA also assessed the bank's own controls and reporting on whether or not approvals were in compliance with the growth guidelines.

The growth regions were limited to Copenhagen, its suburbs and the City of Aarhus.

### **Summary and risk assessment**

The FSA's assessment of whether or not approvals were in compliance with the growth guidelines was based on a review of a sample of 44 approvals that had led to the establishment of loans in the period covered by the inspection and on a data analysis of all the bank's approvals of loans for purchases of owner-occupied homes in growth regions in the period covered by the inspection. The FSA also reviewed the results of the bank's own controls in relation to the growth guidelines.

As stipulated in the growth guidelines, financial institutions must pay particular attention to ensuring that customers buying homes in growth regions have robust finances.

Some 39% or more of the approvals for purchases of owner-occupied homes in the period covered by the inspection did not comply with the growth guidelines. This is a much higher percentage than the percentages of the five other banks inspected. The main deviation was that a considerable number of the customers had a high debt-to-income ratio without sufficiently large net assets. In addition, a number of customers had negative net assets without making sufficiently large payments on their debts, or customers had an inadequate amount available for consumption as calculated on the basis of a fixed rate of interest (with interest-rate stress, if applicable) and a maximum repayment period of 30 years. Other data showed that the bank's approvals were made for customers with a higher risk than at the other banks inspected. For example, Danske Bank had granted interest-only periods for more than 80% of the approvals, and the average interest-only period was the longest among the banks inspected.

Prior to the inspection, the bank itself had identified that many approvals failed to comply with the growth guidelines. As a consequence, the bank had introduced a number of measures in 2017, and its

controls showed at the end of 2017 that the number of non-compliant approvals had fallen considerably. Even when allowance is made for the effect of the bank's measures, the number of approvals failing to comply with the growth guidelines was too high. The bank was ordered to ensure that customer finances are sufficiently robust in connection with the approval of home loans in growth regions.

The bank's own independent credit controls to check whether approvals were in compliance with the growth guidelines were based on quarterly spot checks of new approvals. The first satisfactory control did not take place until mid-2017. The FSA issues a reprimand to the effect that the independent credit controls were initiated too late.

The reports of the bank's independent control function did not show which acceptable deviations made the approvals justifiable although they did not comply with the stipulations of the growth guidelines. The findings of the inspection mean that the bank, in its spot checks, will in future register and report on cases where, in relation to approvals, other types of measures are used than those specified in the business procedures.

The internal audit function had not performed any special audits in relation to the growth guidelines. The FSA finds that the bank's home loans for purchases of owner-occupied homes in growth regions are a material and high-risk area that must be subjected to an operational audit. The FSA issued a reprimand to the effect that the internal audit function had not previously performed any audit of the bank's implementation and controls in relation to the growth guidelines.