

MEMORANDUM

The Danish Financial Supervisory Authority
13 April 2021

Statement on inspection of Danske Bank (impairment charges in the light of COVID-19)

Introduction

In October 2020, the Danish Financial Supervisory Authority (the Danish FSA) conducted an inspection of the Danske Bank Group's loan impairment charges.

The purpose of the inspection was to assess whether the bank had made adequate impairment charges at 30 June 2020, including in the light of the adverse effects of COVID-19 on the Danish and international economies. The Danish FSA also examined whether the loans were placed in the correct stages in accordance with the impairment rules.

The inspection involved business and personal customers in Denmark, Sweden, Norway, Finland and Northern Ireland.

Summary and risk assessment

The Danish FSA's assessment of the bank's impairment charges and staging was based on a review of selected business procedures and loans to 205 business customers and 129 personal customers. In its assessment, the Danish FSA also considered the impairment charges that the bank had made in the form of management overlays and which were relevant for the loans in question. Prior to the selection of customers, the Danish FSA discarded customers with the best ratings/scores, fully secured exposures and customers with modest bank exposures. The Danish FSA also discarded personal customers with exposures that had been written down by more than 95%. Consequently, the Danish FSA's conclusions do not apply to these elements of the bank's customer portfolio.

The Danish FSA observed that additional impairment charges were needed in respect of the selected loans. The impairment charges against loans to business customers were increased by a net DKK 136 million. One large loan accounted for DKK 111 million of the increase. The impairment charges against loans to personal customers were increased by a net DKK 57 million. Of this amount, DKK 51 million related to one large and atypical loan, which, like several other personal customer loans subject to additional impairment charges, was from the bank's Private Banking department.

The Danish FSA's review of the loans indicated that the bank's impairment charges at 30 June 2020 could be too low for large business customers with OEC (objective evidence that financial assets are credit-impaired) and for the portfolio of personal customers from which the customers were selected – even when management overlays for these specific portfolios are taken into account. The selected business and personal customers represented a small proportion of the bank's total lending, and the Danish FSA therefore had no basis for making a safe estimate of the need for additional impairment charges for the populations by multiplying the results of the review. The bank must inform the Danish FSA of how it took the observations into account in the preparation of the Group's 2020 financial statements for the purpose of ensuring that the total impairment charges were adequate. The external auditors must also address this issue.

The primary reason for the additional impairment charges against loans to the selected business customers was that, in several cases, the bank's manual impairment calculations had been based on overly optimistic scenarios or scenario weighting. The bank was ordered to ensure that the manual impairment calculations include realistic and well-founded scenarios.

For the selected personal customers, the typical reason for the additional impairment charges was that the bank had failed to identify objective evidence of impairment (OEC) in the form of significant financial difficulty. This was also the case for a few business customers. The bank was ordered to ensure that it identifies OEC in accordance with the accounting rules.

The Danish FSA detected errors and omissions in the data lists submitted by the bank for use by the Danish FSA in its selection of loans. This meant that the bank had to submit new data lists or corrections to the lists several times. The Danish FSA found that errors in the data submitted would also imply a risk of errors in the management information about the bank's portfolios. The bank had no formalised processes or controls to ensure that data etc. submitted to the Danish FSA did not contain errors.

As a result, the bank was ordered to introduce procedures for data controls, error corrections etc. to ensure that the Danish FSA receives accurate data etc. in connection with inspections.