

MEMO

**DANISH FINANCIAL
SUPERVISORY AUTHORITY**

7 December 2011

J.no.

Supervisory disclosure of the Danish SREP

Scope of application of SREP

In Denmark, the scope of application of the ICAAP requirement follows the scope laid down in the implementation of the Capital Requirements Directive 2006/48/EC and the Capital Adequacy Directive 2006/49/EC. The ICAAP requirements are applied at the consolidated and on solo level. The Danish Financial Supervisory Authority (DFSA) has the opportunity to exempt the ICAAP requirements at a consolidated level in certain circumstances and has the right to demand ICAAP requirements on a sub-consolidated level.

Individual risk assessment

Financial institutions in Denmark are subject to an individual risk assessment. Assessments based on off-site reporting as well as additional information available to the DFSA are used to prioritise the on-site inspection schedule. Institutions with larger risks are subject to intensified supervision, often involving more frequent reporting. Large institutions are subject to comprehensive inspections over a three or four year cycle, medium sized institutions are examined at least every four years, while smaller low-risk institutions are examined at least every six years. In the large bank groups, at least one risk area is inspected each year and the DFSA meets at least annually with their management.

The individual risk assessment is based on different sources of prudential returns and is carried out in a mix of absolute and relative measures.

Review and evaluation of ICAAP

Under section 124(1) of the Financial Business Act, the board of directors and board of management have to ensure that the institution has adequate capital and has internal procedures to measure and manage the risks and on an ongoing basis assess and keep sufficient own funds to cover the risks faced by the institution. Furthermore, the board of directors and board of

management have the obligation to assess and calculate the individual pillar II capital requirement. The pillar II figure shall be expressed as the sufficient capital to cover the risks as a percentage of the risk-weighted items. The pillar II figure may not be less than the minimum capital requirement of eight percent. The DFSA may set a higher pillar II capital requirement than calculated by the institution. The institution shall make its individual pillar II capital requirement publicly available on its website or in the yearly financial report.

The DFSA assesses the institution's ICAAP as part of the SREP. The DFSA goes through the ICAAPs of all banks and credit mortgage institutions once a year, except for the smallest banks. During the risk assessment process each main risk area is under consideration and the result of the institution's ICAAP is an integrated part of these risk assessments. This includes a consideration of the assumptions, components, methodology, coverage and outcome of the institution's ICAAP. The review covers the institution's material risk areas, risk management processes and systems of internal control. Various stress-testing is part of the review process and is related to the institution's assessment of adequate capital. The ICAAP is further described in Annex 1 of Executive Order on Capital Adequacy and is based upon CEBS's Guidelines on the Application of the Supervisory Review Process under Pillar 2. The DFSA has made a guideline on the ICAAP framework and pillar II calculation. The DFSA does not as such approve the institution's ICAAP as the adequate capital changes on an ongoing basis. In case of disagreement, the DFSA will enter into a dialogue with the institution. Ultimately, the DFSA may set a higher pillar II capital requirement – which in that case is done in connection with an on-site inspection.

The review process carried out by the DFSA is based upon the institution's own ICAAP. In its assessment of whether the DFSA shall determine a higher pillar II capital requirement than calculated and assessed by the institution, the DFSA will emphasise the same matters as the board of directors and the board of management should emphasise when calculating the individual pillar II figure. The DFSA's assessment will, however, also include the DFSA's assessment of the board of directors and the board of management – including their competences and approach to risk-taking.

Overall assessment and supervisory measures

If the DFSA considers in course of its supervisory review process and after an extensive dialogue with the individual institution that an institution's ICAAP does not adequately reflect its overall risk profile, or does not result in the institution having adequate capital, then considerations will be given to apply prudential measures including:

1. Determining a pillar II capital requirement that is higher than the minimum requirement, cf. section 124(5) of the Financial Business Act;

2. Requiring the institution to apply a specific provisioning policy or treatment of assets in terms of own funds requirements, cf. section 124(6) of the Financial Business Act;
3. Requiring the institution to improve its internal control and risk management frameworks, cf. section 71 (1) of the Financial Business Act;
4. The DFSA may in accordance with section 350(1) of the Financial Business Act order that a financial undertaking take the measures necessary within a time limit specified by the DFSA, if 1) the financial position of the undertaking has deteriorated to such a degree that the interests of the depositors, the insured parties, the bond owners, the investment associations, the special-purpose associations, the approved restricted associations, the hedge associations, other collective investment schemes or other investors are at risk, or 2) there is a significant risk that the financial position of the undertaking will develop so that the undertaking will lose its license due to internal or external circumstances.

Under section 225(1) of the Financial Business Act, the DFSA is required to withdraw the license of the undertaking if it does not meet the pillar II capital requirement after a time limit stipulated by the DFSA.