FINANSTILSYNET

Banks

Market Developments 2011

Market developments for banks in 2011

1. Conclusions

The continued weak economic environment is affecting banks, resulting in weak earnings and a continuing high level of impairments. Overall, banks earned profits of DKK 3.6 bn. before tax compared with a profit of DKK 4.1 bn. in the previous year.

Impairments on loans for the year amounted to DKK 24 bn. which, although somewhat less than the previous year (DKK 36 bn.), reflect a significant increase in Q4 2011 compared with the first three quarters of the year. In relative terms, impairment losses are 1.1% of lending and guarantees against 1.4% in the previous year. Continued high impairments on loans are expected in 2012.

New regulations for impairment losses on weak loans took effect 1st April 2012.[1] The new regulations include a relevant tightening of rules for distressed property loans. Many banks are already applying this new approach to impairment losses on their property lending. These banks will have to increase impairment losses on the loans for which they have previously applied other approaches. This is likely to result in an increase in their total impairment losses, although the increase will be modest in most cases. However, there will be a small group of banks for which the increase may have a sizeable effect on their total impairment losses.

Overall, the capital situation of banks is stronger and the assessment is that most banks, including the largest, will be able to absorb larger credit losses. The financial resilience of banks - capital compared to the statutory requirement (solvency need) - amounted to 7.2% of lending and guarantees at the end of 2011 against 5.4% in the year before. However, the sector-wide figure covers a considerable dispersion between banks, and a number of smaller banks are being challenged by weak credit quality and a vulnerable capital situation.

---

[1] See the Danish FSA website: http://www.finanstilsynet.dk/da/Nyhedscenter/Pressemeddelelser/2012/Nye-nedskrivningsregler-nu-paa-plads.aspx

The funding situation for the sector is moving towards a better balance and the sector's total deposit deficit fell in 2011 from DKK 326 bn. to DKK 161 bn. When adjusted for repurchase agreements (repos), the deposit deficit comes to DKK 71 bn. This development includes a drop in lending of DKK 167 bn., concentrated mainly on repos and corporate lending. On the other hand, deposits remained more or less steady with a slight drop of DKK 2 bn. (0.1%).

There are still banks facing challenges with regard to expiry of the individual state guarantees in 2012 and especially in 2013. As part of its ongoing monitoring of the issue, the Danish FSA has requested reports from these banks, and is monitoring developments closely.

Overall the situation has improved during 2011 and in early 2012. Firstly, the instruments in Bank Packages IV and V[2] have helped improve challenged banks' solution options. Secondly, the new lending facilities from Danmarks Nationalbank are providing relief with regard to the expiry of the individual state guarantees. Finally the banks themselves have adjusted their balance sheets by reducing lending and increasing deposits.

In conclusion, the general assessment is that the funding and liquidity challenges have become significantly smaller. Looking forward, however, new challenges are on the way, stemming from the new liquidity regulations in Basel III/CRD IV.

See part 5 for general comments on the statistics behind the analysis article, including the data foundation.

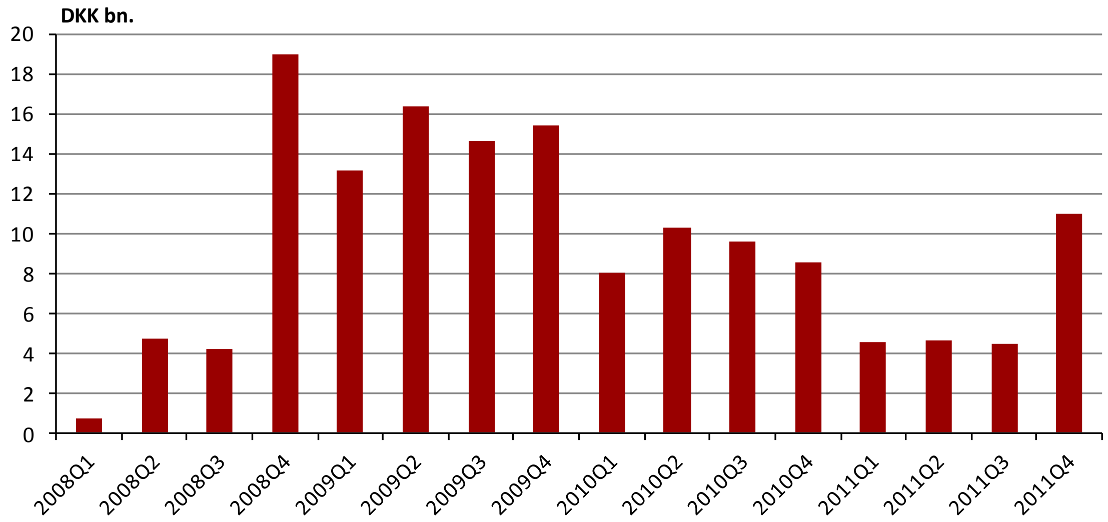
2. Main trends in banks' financial statements[3]

Banks' financial statements have been especially hard hit by falling core earnings and continued high impairment losses and provisions on lending and guarantees. Impairment losses for the financial year as a whole were less than in the previous year, but they increased considerably in Q4 2011, see figure 1.

[2]Correctly called "consolidating initiatives" (Bank Package IV) and "the development package" (Bank Package V), see www.evm.dk. See appendix 7 for a description of Bank Packages IV and V.

[3]At the end of 2011, a total of 113 banks were being supervised by the Danish FSA, divided into groups 1-4. In addition there were four Faeroese banks. Branches of foreign banks in Denmark are not included. Groups 1-3 account for about 99% of the balance sheet total of banks. Appendix 6 shows the break-down of the individual banks within the respective groups 1-4.

Figure 1: Quarterly impairments on loans and guarantees 2008-2011



Source: Reports to the Danish FSA.

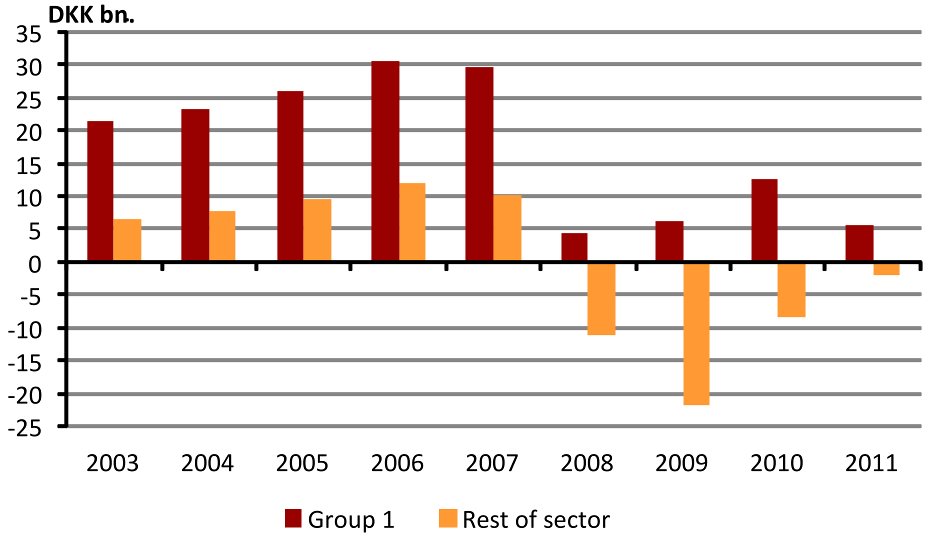
The capital base of banks is a buffer against continued credit losses in the future. Both core capital and the solvency ratio for the sector as a whole rose in 2011. This rise is attributable to an increased level of capital as well as a reduction in banks' lending and risk-weighted items.[4]Solvency ratio and core capital ratio are calculated as capital base and core capital respectively in relation to risk-weighted items, see the table of developments in appendix 4.

Excess coverage in relation to the capital requirements had risen to 7.2% of lending and guarantees at the end of 2011. However, the sector figures conceal a large disparity, and some banks are vulnerable to continued credit losses in their loan portfolios. Part 3 contains a closer review of the capital positions.

Overall, banks earned profits of DKK 3.6 bn. before tax in 2011, compared to profits of DKK 4.1 bn. before tax in 2010. See excerpts from banks' overall financial statements in appendix 1. The positive net earnings for the sector are still primarily attributable to group 1, see figure 2, with profits before tax of DKK 5.6 bn., although profits are less than half of the preceding year. The rest of the sector suffered overall losses in 2011, although these were considerably lower than for the year before.

[4]The statement at group level is based on figures from the banks which also report as groups, i.e. a consolidated statement on the basis of activities in both the parent bank and subsidiaries.

Figure 2: Profit before tax 2003-2011



Source: Reports to the Danish FSA.

In 2011 banks charged to the income statement net impairments on loans of DKK 24 bn. against DKK 36 bn. in the preceding year. The impairment loss ratio for the year (impairment losses and provisions measured in relation to lending and guarantees) for the sector as a whole was 1.1% in 2011 compared with 1.4% in 2010. However there was a large dispersion between banks. In table 1 different fractiles for the impairment loss ratio are presented.

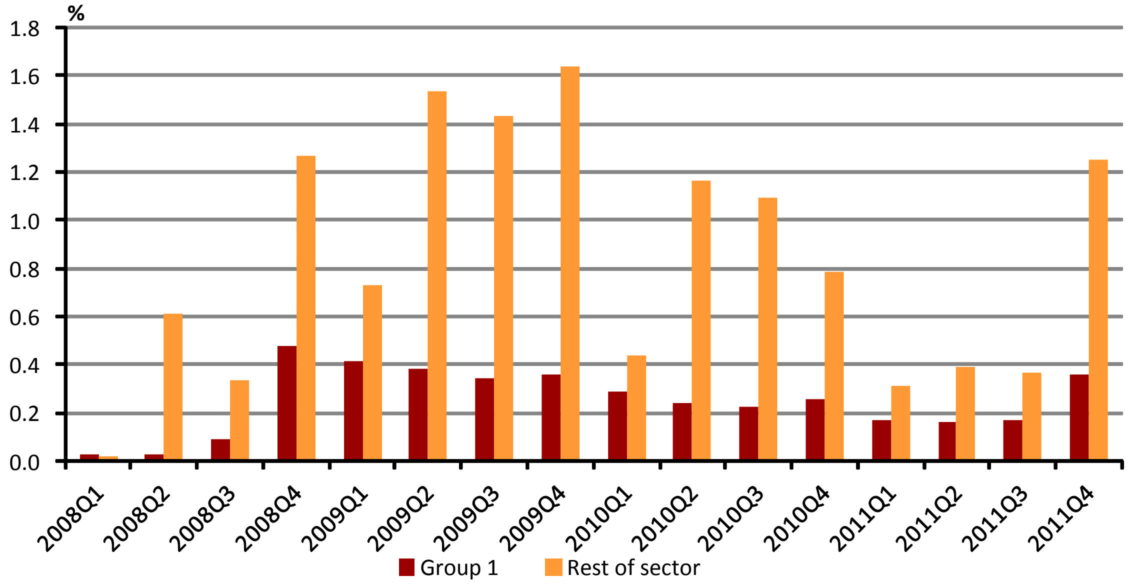
Table 1: Annual impairments on loans as percentage of loans and guarantees - dispersion 2011

Percentiles					Weighted average
10%	*25%*	*Median*	*75%*	*90%*	
0.25	0.78	1.40	2.84	3.68	1.08

Source: Reports to the Danish FSA.

The table shows that 10% of banks have charged impairment losses of 3.7% or more to their income statement; a level considerably above the weighted average. In relation to outstanding lending, the impairment losses are considerably lower for the largest banks, see figure 3.

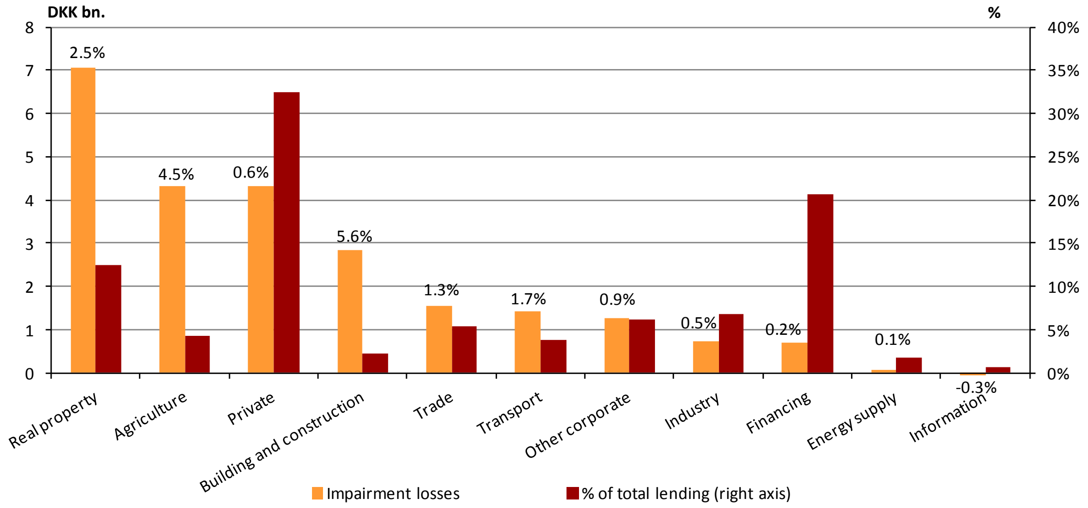
Figure 3: Quarterly impairments on loans and guarantees; group 1 against the rest of the sector 2008-2011



Source: Reports to the Danish FSA.

In 2011 banks charged to the income statement the largest total impairment losses on property-related exposures, see figure 4. Relative to outstanding lending, the impairment loss ratio for the year is highest on building and construction, followed by agriculture. These two sectors account for a relatively modest proportion of the total lending by the sector (7%), however impairment losses amount to a significant percentage (30%) of the total impairment losses charged to the income statement.

Figure 4: Annual impairments on loans - by sector, 2011



Note: The impairment loss ratio charged to the income statement for the individual sectors is shown above the columns.
Source: Reports to the Danish FSA.

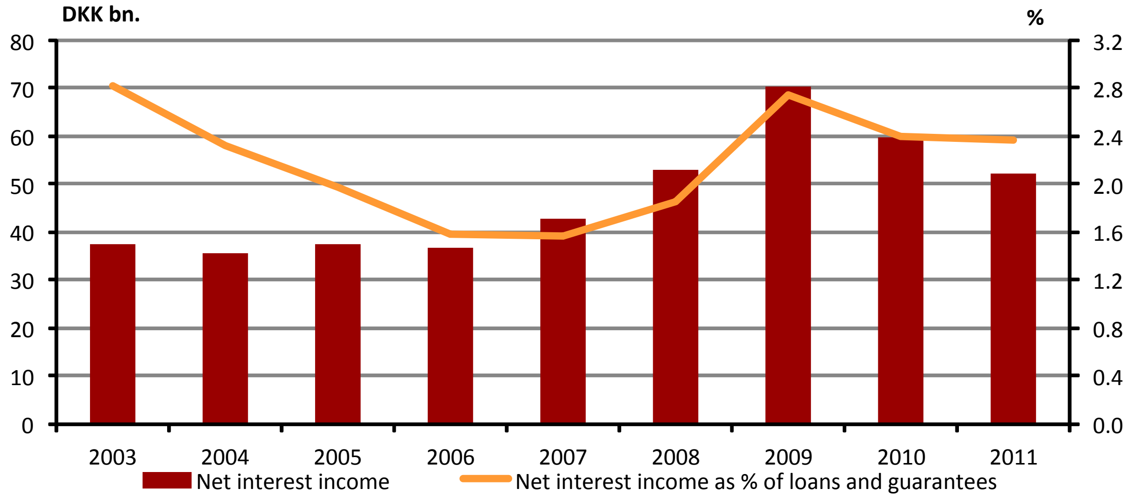
Developments within agriculture constitute a serious credit risk for a number of mostly smaller banks, which have a relatively large exposure to agriculture. Despite improvements in settlement prices for agriculture, many farms are still suffering from poor earnings and liquidity, in part due to their high level of debt. In addition there is an impact of falling land prices.

Considering the sector as a whole, a total of 20 banks have exposures to agriculture of more than 15% of lending and guarantees. However, in relation to the aggregate balance sheet total, these banks constitute a small part of the sector - less than 3%.

In absolute terms, impairment losses on households charged to the income statement are high, but because loans to households amount to a large share of total lending, it results in a relatively low impairment loss ratio of 0.6%. During the financial crisis, households (and banks' impairment losses on households) have been favoured by relatively low unemployment and low interest rates.

In 2011, banks' net interest income fell from DKK 59 bn. to DKK 52 bn., corresponding to 13%, see figure 5.

Figure 5: Net interest income, 2003-2011



Source: Reports to the Danish FSA.

The drop is primarily attributable to lower volumes of lending. Pressure on net interest income from the narrow deposit margins and higher funding costs has therefore been countered by wider lending margins for both households and businesses in the second half of 2011. This has also meant that the general interest-rate differential, that is the difference between the interest rate on banks' lending and deposits, has increased during 2011.[5]However the picture is not quite so clear-cut, as net interest income as a percentage of lending and guarantees in 2011 is at par with 2010.

Net fee and commission income fell from DKK 18.8 bn. to DKK 18.4 bn. (2%) in 2011. Fees and commissions from securities trading and custody accounts constituted the largest share - almost 38% - of total charges income for 2011.

Market value adjustments on securities holdings etc. contributed positively to earnings in 2011, with total capital gains of DKK 2.1 bn. This is DKK 2.9 bn. less than in the previous year. Holdings of bonds in particular, as well as currency, contributed to net capital gains, in contrast to net capital losses on shares and issued bonds.

[5]For corporate customers, the interest-rate differential was extended from 3.4 to 3.9 percentage points in 2011, and for households the interest-rate differential was increased from 4.1 to 4.5 percentage points, see interest statistics from Danmarks Nationalbank.

Banks' lending fell by DKK 167 bn. (8.6%) in 2011 for the year as a whole. The fall was particularly large for corporate lending. In group 1 the drop in lending can be attributed to repo transactions.[6]

Equity increased by DKK 20 bn. in 2011 to DKK 270 bn., and this is primarily attributable to higher profits in the largest banks as well as share issues, again primarily in group 1.

3. Credit risk, impairment losses and solvency

Credit risk and impairments on loans are decisive for the results of banks and their capital position. The first buffer against credit losses is core earnings. In 2011 a number of banks had negative core earnings and therefore their equity reserves diminished. Furthermore, a number of banks had relatively weak positive core earnings, making them vulnerable to increasing impairment losses going forward.

New regulations for impairments on loans include a number of necessary restrictions and clarifications in relation to the identification and assessment of impairment losses on weak loans, including property exposures and “parking” exposures. The Danish FSA expects that the new regulations will result in fewer supervisory reactions to inadequate impairment losses and solvency reserves.

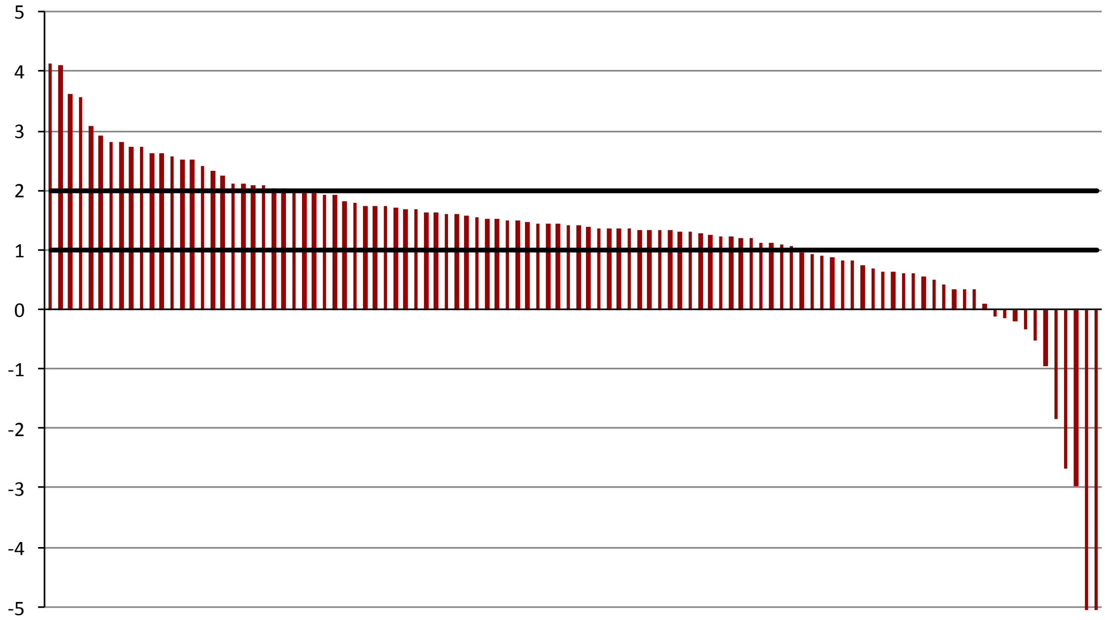
Capital buffers of banks, defined as the capital banks have in excess of the statutory requirement, strengthened in 2011, making banks more resilient to credit losses . However there is a considerable dispersion between individual banks.

Core earnings

Core earnings should generally be proportioned so that they cover the expected losses on lending activities, such that only large unexpected losses need to be absorbed by equity reserves. In order to obtain an impression of the robustness of core earnings to losses on lending activities, total core earnings for all banks have been compared with the size of lending and guarantees, see figure 6. Core earnings in this context are before impairment losses, market value adjustments, and profits/losses on participating interests.

[6] The drop in group 1 is primarily due to repo transactions, which are no longer entered in Danish books. For accounting purposes, repos (and reverse repos) are treated as deposits and loans respectively, provided the transactions are not with other credit institutions. If the transactions are with credit institutions, the repo (and reverse repo) is entered as debt to credit institutions or receivables from credit institutions, respectively.

Figure 6: Core earnings as percentage of loans and guarantees 2011



Note: Core earnings contain all income statement items except impairments on loans, market value adjustments and profits/losses on participating interests. The figure does not include banks in the Financial Stability Company and small specialist banks with limited lending in relation to their total assets.
Source: Reports to the Danish FSA.

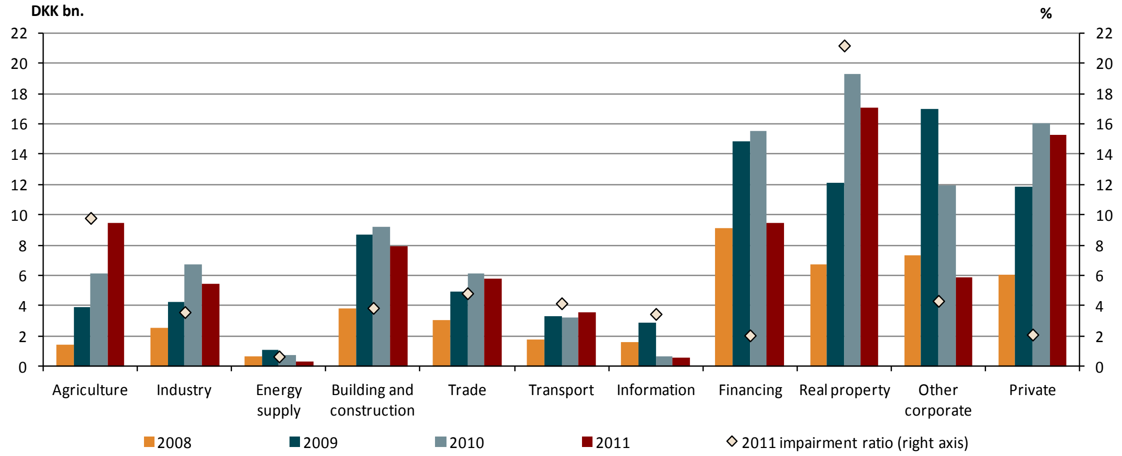
In 2011, 11 banks had negative core earnings before impairment losses and therefore are currently drawing on equity to cover losses. These 11 banks comprise 0.4% of the sector's aggregate balance sheet total. The bold lines in the figure show impairment losses at different levels. For impairment losses at 1% of lending and guarantees, corresponding to the average for the sector in 2011, 30 banks would not have adequate core earnings. For impairment losses at 2% of lending and guarantees, corresponding to a considerable deterioration in the macro-economic situation on a par with 2009, which has been the worst year of the current financial crisis, 80 banks would have inadequate core earnings.

Accumulated impairment losses by sector

Accumulated impairment losses are the total impairment losses on loans which the banks still have on their banking book (balance sheet) [7]. At the end of 2011 banks' largest total accumulated impairment losses were on property-related exposures, see figure 7.

[7] More correctly both impairments on loans and provisions for losses on guarantees have been accumulated in this statement. Guarantees are outside the balance sheet until a provision is made for a guarantee liability, and entered in the balance sheet as provisions for losses on guarantees.

Figure 7: Accumulated impairment loss ratio 2007-2011



Note: In calculating the allowance account, losses ascertained on loans which are not on the banks' loan books are no longer excluded. The Danish FSA has changed the sector grouping to follow the DB07 standard from and including 2010. Sector data for 2008-2009 has been adjusted so that it is comparable with data for 2010-2011. The impairment loss ratio for the 'building and construction' sector has been adjusted for 'completion of building projects' which has been added to the 'real property' sector to correspond with the statement of 'property exposure' in the supervisory diamond. There is a more detailed description of the supervisory diamond on the Danish FSA website at www.finanstilsynet.dk/en/Temaer/Strategi-2011/Tilsynsdiamanten.aspx

Source: Reports to the Danish FSA.

Relative to outstanding loans, the impairment loss ratio is also largest for property-related exposures (21.2%), when account is taken of the property-related part of the 'building and construction' sector (building projects). The accumulated impairment losses on the loans to building projects which banks have on their banking book amounted to a total of 30% at the end of 2011.

New regulations for impairment losses on weak loans

On the basis of, amongst other things, experience from the bankruptcy of Amagerbanken, the Danish FSA instigated an amendment to the Danish Executive Order on Financial Reports with regard to the regulations on impairment losses. The aim is to establish a clearer framework for banks to estimate impairments on loans.

In the opinion of the Danish FSA, the international accounting regulations provide a wide range of possibilities for management judgement of impairment losses. At the same time, inspections by the Danish FSA show that many banks have inadequate write-downs for impairment losses, see box 1. Therefore, the Danish FSA has narrowed the scope for justifying when an assessment is appropriate and well-founded.

Box 1: Changes in loan impairments and solvency needs as a result of inspections

At the majority of inspections conducted by the Danish FSA, the Authority has assessed that the bank initially has not made adequate allowance for impairment losses, nor has it made adequate solvency reserves. Usually, these banks have not taken adequate account of the weak economic environment and the consequential deterioration in the credit quality of their loans.

A closer review of the inspections conducted by the Danish FSA over the past two years shows that, in particular, banks with higher exposure to corporate customers (more than 60% of lending) have not allowed for adequate impairment losses and solvency reserves.

The review also shows that in particular banks with lending concentrated in a few sectors have not allowed for adequate impairment losses and solvency reserves.

Therefore, the banks which are ordered to make larger impairment losses and solvency reserves are primarily those with exposure to corporate customers and those with a high concentration risk. These banks have accepted a greater risk than other banks and have not initially covered these risks with adequate levels of capital.

The key parts of the amendments to the Danish Executive Order on Financial Reports comprise tighter rules for impairment losses on distressed property exposures and parking exposures, as well as a clarification of when there is objective evidence of impairment. The pivotal point in the new regulation is that, in future, loans to property customers in distress must be written down to the value of the property. If a customer does not have other substantial means to repay the loan, the bank has to write down the

Box 2: Credit survey

In autumn 2011, the Danish FSA initiated collection of supplementary credit-related information on the largest loans from all banks.

The credit information covers a number of the lending areas which have brought banks into difficulties over the past three years. For example the Danish FSA has gathered information on collateral in banks' large property-related lending exposures, the proportion of foreign property exposures, exposures with limited partnerships, and mortgage exposures.

The Danish FSA also collected information on the percentage of banks' loans in arrears and the percentage of exposures in which the banks had taken part in a reconstruction, for example by granting extended repayment terms, as well as the extent of parking exposures, i.e. distressed exposures which are transferred to a new owner without the new owner being liable, or to previous owners, but in a new construction. The survey showed that 26 banks reported using parking exposures.

The survey also showed that 10% of banks had about 8% or more of their exposures with arrears. See the distribution below.

Percentage of exposures consisting of exposures with arrears of 90 days or more

		Percentiles		
10%	*25%*	*Median*	*75%*	*90%*
0.11	0.74	1.75	4.73	7.77

The results of the credit survey have been included in the Danish FSA's risk assessments and inspection planning, and specific banks have been asked to account for their impairment losses in more detail. Model tools are included as part of the assessment by the Danish FSA, which attempt to couple banks' credit profiles with expected levels of impairment losses. Finally, the credit survey has contributed to deliberations by the Danish FSA regarding the new regulations for impairment losses on weak loans.

loan to the current value of the collateral, i.e. the amount the property is likely to be sold for within six months. The same applies for loans utilising risky business methods such as parking transactions, in which distressed lending exposures are transferred on favourable terms to other customers, see box 2.

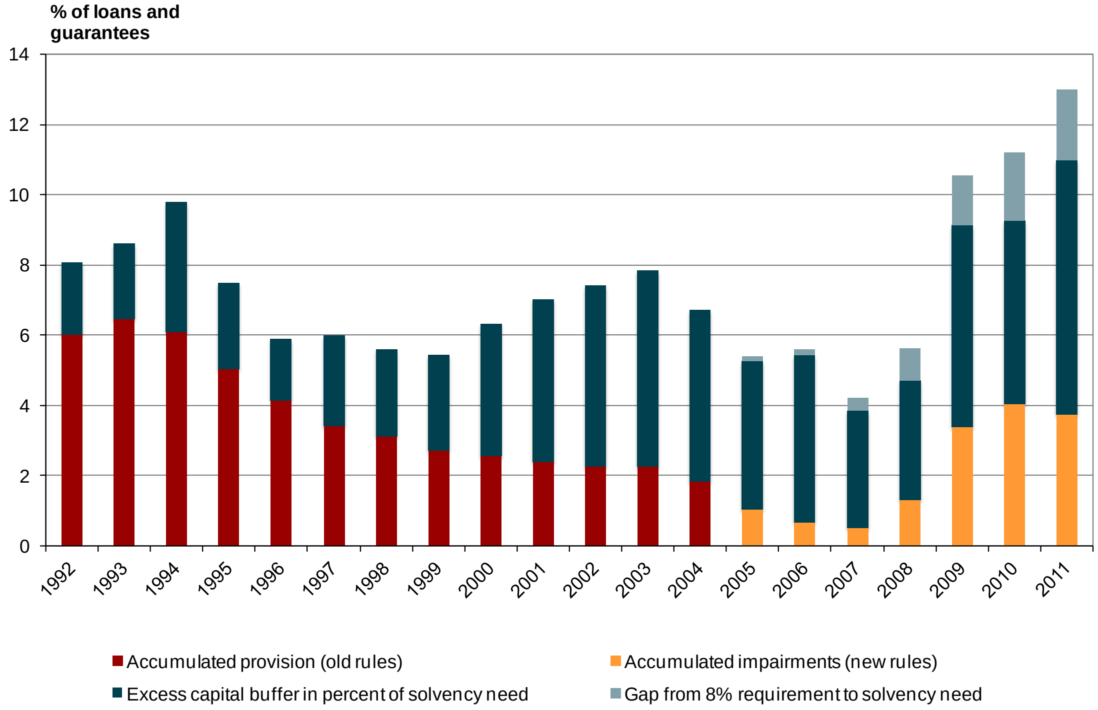
New regulations for impairment losses on weak loans took effect 1. April 2012.[8] The new regulations include a relevant tightening of rules for distressed property loans. Many banks are already applying this new approach to impairment losses on their property lending. These banks will have to increase impairment losses on the loans for which they have previously applied other approaches. This is likely to result in an increase in their total impairment losses, although the increase will be modest in most cases. However, there will be a small group of banks for which the increase may have a sizeable effect on their total impairment losses. The Danish FSA expects that in future it will issue fewer orders in connection with inspections, because the regulation has become more precise.

Capital and solvency need

Ultimately, the resilience of banks to increasing credit losses should be measured in relation to capital excess coverage, see figure 8, which shows the total buffer over time.

[8] See the Danish FSA website: http://www.finanstilsynet.dk/da/Nyhedscenter/Pressemeddelelser/2012/Nye-nedskrivningsregler-nu-paa-plads.aspx

Figure 8: Impairments and capital buffers 1992-2011



Note: From 2005 onwards, capital buffers have been calculated on the basis of the solvency need reported by banks. The distance from the 8% requirement to the solvency need has been calculated after taking into account the transitional scheme. The largest value of the solvency need, capital requirement according to the transitional scheme and the minimum capital requirement, has been included. The transitional scheme means that the new Basel II rules will not have their full impact on the capital requirements until after 2011. IRB institutions must have a capital base amounting to at least 80% of the solvency requirement calculated in accordance with the regulations applying previously (Basel I).
Source: Reports to the Danish FSA.

At the end of 2011, banks could lose 7.2%[9] of their lending and guarantees before their capital buffers would fall below the statutory requirement.[10] The accumulated impairments on loans and guarantees already made amounted to 3.5% of lending and guarantees in 2011. Reserves for future losses which have not yet materialised in objective evidence of impairment must be included in the solvency need.

However, there is a large disparity between banks in their capital buffers, see table 2. A total of 10% of banks have capital buffers of less than 2.1%. These banks only account for 2.1% of the balance sheet total for the whole sector.

[9] As mentioned above, current earnings are the first buffer before eating into reserves. However, the 2011 financial statements show that not all banks have a profit to utilise.

[10] The statutory requirement is set as the solvency need submitted by the banks.

Table 2: Capital buffers, 2011

Percentiles					*Weighted average*
10%	*25%*	*Median*	*75%*	*90%*	
2.1%	5.1%	7.4%	11.9%	19.2%	7.2%

Note: Banks under the Financial Stability Company have been excluded.

Source: Reports to the Danish FSA.

4. Funding and liquidity

Funding and liquidity is a crucial risk area for banks. The funding situation is more balanced and the funding structure has changed in a way that reduces banks' dependency on, and vulnerability to, market-based funding.

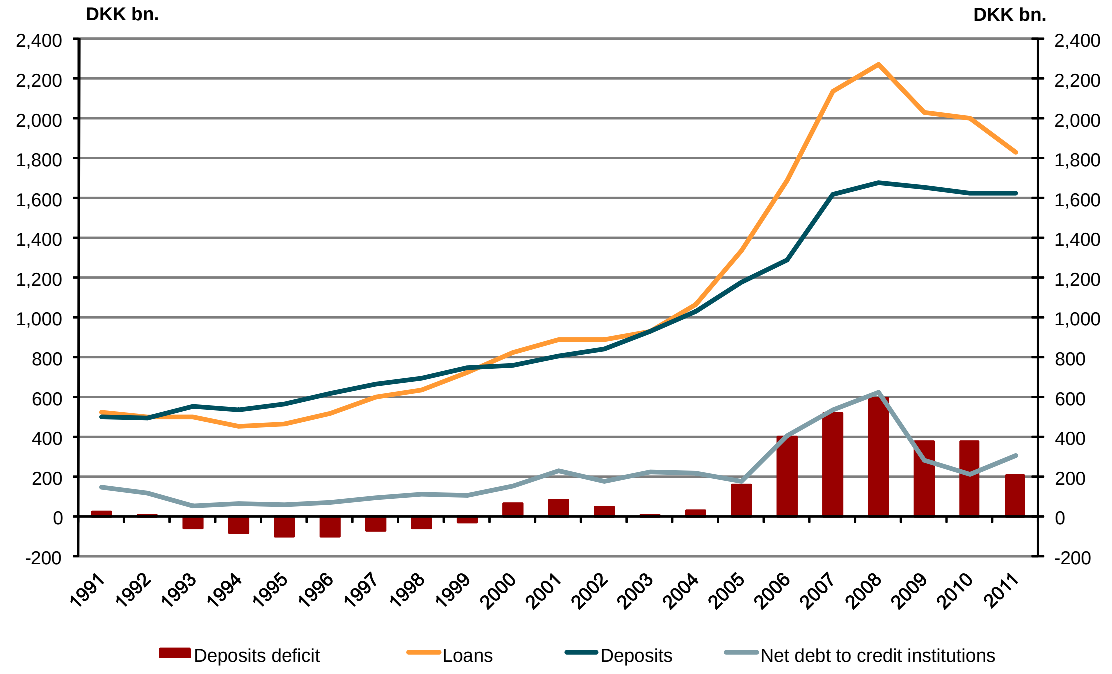
Some banks still face challenges, but even the challenged banks are showing improvements. New lending facilities from Danmarks Nationalbank are also helping relieve the situation.

New international regulations on liquidity are on the way and the requirements on scope and composition of liquid funds will challenge the sector. In particular, the fact that the present draft does not allow the inclusion of mortgage-credit bonds in liquid funds to the same extent, will challenge banks.

Deposit deficit for banks

At the end of 2011 the deposit deficit was DKK 161 bn.; a reduction of DKK 165 bn. compared with the year before, see figure 9.

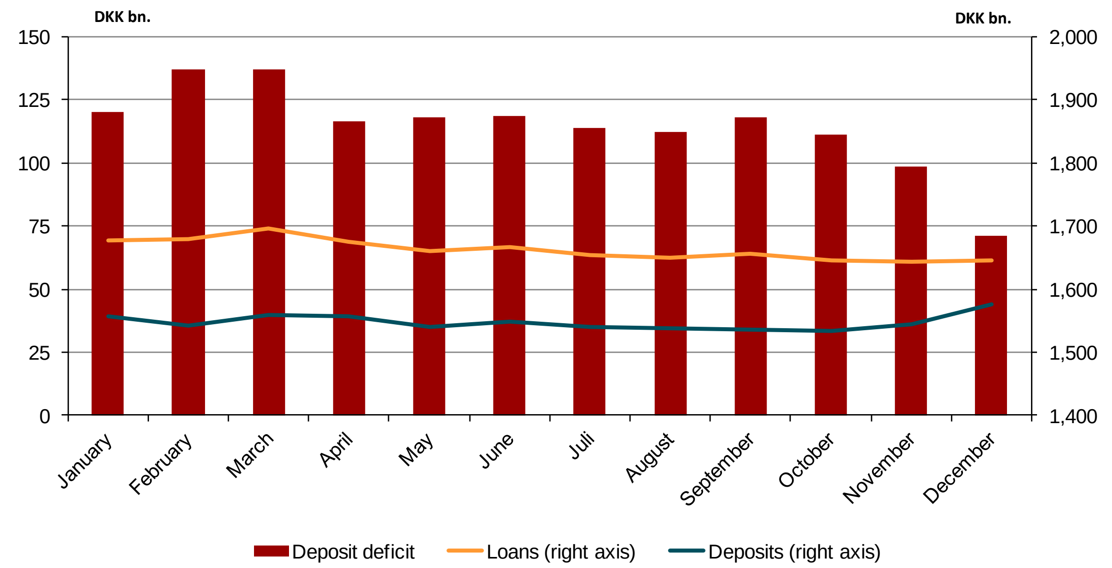
Figure 9: Loans, deposits and net positions to credit institutions 1991-2011



Source: Reports to the Danish FSA.

Corrected for repos (sale and repurchase transactions)[11] banks' total deficit of deposits amounted to more than DKK 120 bn. at the start of 2011, see figure 10.

Figure 10: Deposits and lending (excluding repos) 2011[12]



Source: Reports to the Danish FSA.

[11] For accounting purposes, repos (and reverse repos) are treated as deposits and loans respectively, provided the transactions are not with other credit institutions.

[12] Changes in deposits and lending have been calculated at bank level, i.e. not at group level.

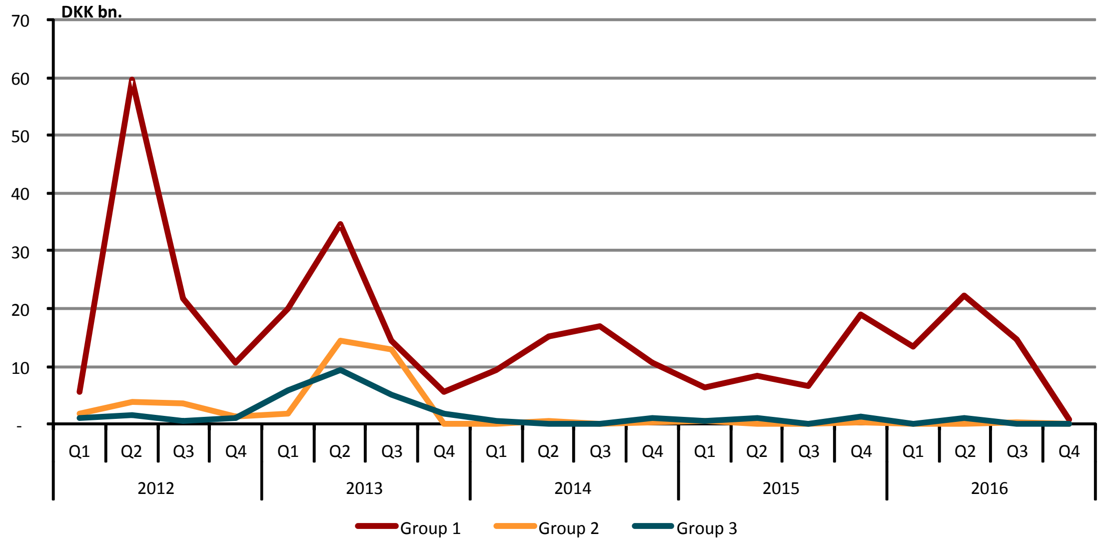
During 2011 the total deposit deficit was reduced by about DKK 50 bn. and amounted to DKK 71 bn. at the end of the year.

Market funding

The deposit deficit must be covered by other sources of funding. The international funding markets have been nervous during 2011, in part as a result of the sovereign debt crisis and the resulting impacts on the financial system. This has meant that, for periods, European banks have not had access to market funding on longer terms.

As a result, 2011 has been characterized by a low level of longer-term unsecured funding issues from Danish banks. At the same time, large sums of funding will mature in the next few years. Figure 11 illustrates the amounts maturing on long sources of funding with an original term of more than one year. The figure shows that amounts due on long funding primarily fall in 2012 and 2013. This is partly because, in the years running up to the financial crisis, large amounts of unsecured senior debt were issued with a five-year term. It is also because issues made in 2009 and 2010 with individual state guarantees will mature; in particular in groups 2 and 3.

Figure 11: Maturity of long-term funding 2012-2016 by group

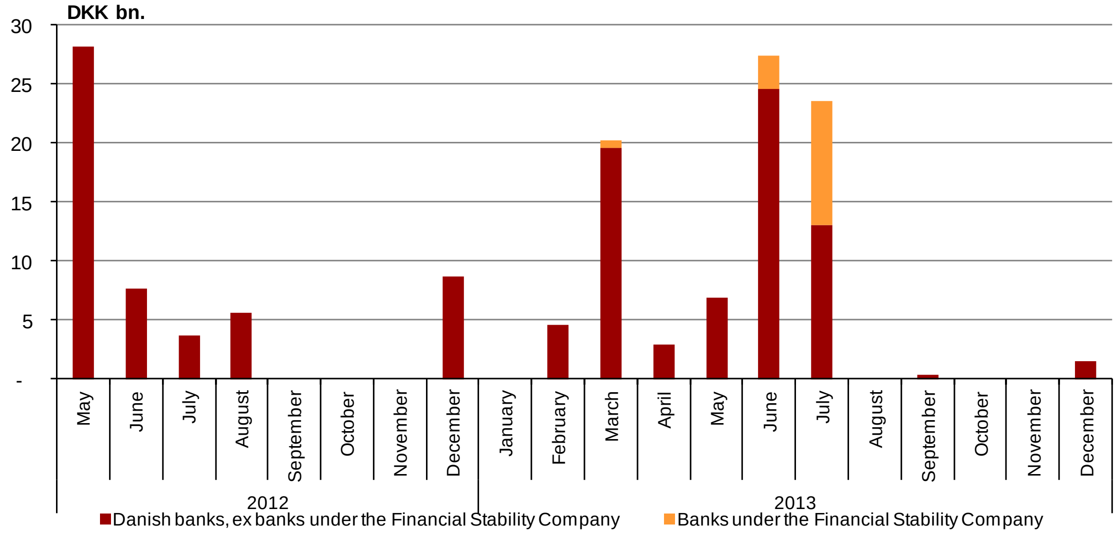


Source: Reports to the Danish FSA.

Not surprisingly, amounts of long-term funding due are greatest for large and medium-sized banks in groups 1 and 2.

The total volume of state-guaranteed issues has fallen from DKK 176 bn. at the start of January 2011 to just less than DKK 129 bn. at the end of March 2012. Of the volume remaining, DKK 28 bn. falls due in May 2012, see figure 12.

Figure 12: Maturity of funding with individual state guarantees



Source: Financial Stability Company A/S

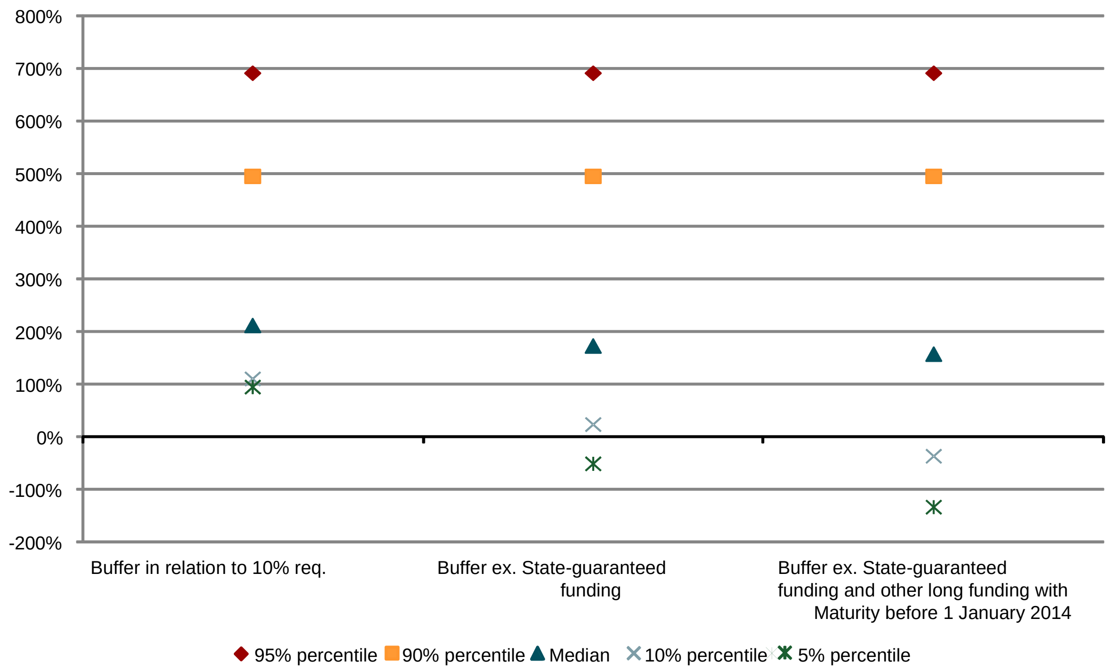
After this, until March 2013 there are only small amounts of state guaranteed issues due, after which the remaining issues with individual state guarantees fall due until July 2013. In June and July 2013, funding with individual state guarantees of about DKK 51 bn. will mature.

The concentration of maturity dates for issues with state guarantees is a challenge for several banks. In the current market environment, it can be a challenge for small and medium-sized banks, in particular, to find alternative long-term market-based sources of funding, especially when amounts mature in the same period.

Excess liquidity

It is especially important that these banks manage expiry of the individual state guarantees. This is emphasised by figure 13, which shows the current liquidity buffers of banks after expiry of individual state guarantees and after expiry of individual state guarantees and other long-term funding, assuming that the funding falling due is not refinanced.

Figure 13: Excess liquidity buffers (Financial Business Act Section 152)



Source: Reports to the Danish FSA.

The figure shows that a number of banks could face a situation in which the liquidity requirement of section 152 of the Financial Business Act cannot be met, unless the balance sheet is changed. In addition, there is the indicator in the "Supervisory Diamond" for an excess coverage of 50%, which even more banks may have difficulties meeting, see FSA website. Therefore, the Danish FSA has requested that challenged banks consider and specify plans regarding the refinancing of individual state guarantees. During 2011 the Danish FSA has regularly followed up on the reports received and in this connection there seems to be a generally positive trend.

Lending facility from Danmarks Nationalbank

In response to the challenges presented by the expiry of the individual state guarantees, in October 2011, Danmarks Nationalbank extended its previous collateral base[13] - especially government bonds and mortgage-credit bonds - by the banks' good quality lending. Extension of the collateral base was to supplement banks' access to raise liquidity and thus support the transition to an environment without individual state guarantees which, as mentioned, expire in 2012 and 2013. Danmarks Nationalbank's lending facility enhances banks' access to liquidity and therefore, in certain

[13] In August 2011 Danmarks Nationalbank extended its collateral base with unlisted sector shares.

circumstances, can be included in their liquidity, see section 152 of the Financial Business Act, as a credit commitment, without drawing on the facility.

Furthermore, in December 2011 Danmarks Nationalbank announced that it would offer banks the option of taking out loans with a three-year term on the basis of Danmarks Nationalbank's collateral base. The first auction of the new three-year loans from Danmarks Nationalbank was held on 30 March 2012, and resulted in loans totalling DKK 18.9 bn.

In light of the option to take out three-year loans from Danmarks Nationalbank, the Danish FSA adjusted the indicator for stable funding (the funding ratio) in the supervisory diamond to include loans from Danmarks Nationalbank with a remaining term of more than one year. However, the Danish FSA stresses that banks which are heavily dependent on the lending facility from Danmarks Nationalbank should continue to work towards achieving a sustainable funding structure.

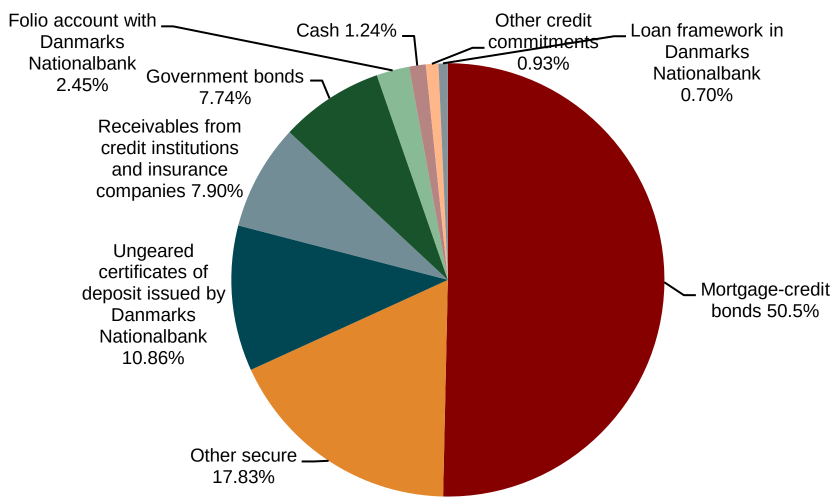
It should be noted that there are corresponding facilities in the ECB which Danish banks operating internationally have also utilised. As a comparison, at two auctions a total of EUR 1,019 bn. have been drawn on the ECB's three-year Long Term Refinancing Operation (LTRO) facility. At the first auction in December 2011 EUR 489 bn. was drawn by 523 banks, while at the auction in February 2012 almost EUR 530 bn. was drawn by 800 banks. The relatively extensive use of the new central bank facilities demonstrates that the market seems to attach no stigma to banks utilising the long temporary central bank facilities.

The solutions established for some banks related to the extension in Bank Package IV and Bank Package V of guarantees for mergers, combined with the initiatives instigated by banks themselves and the lending facilities from Danmarks Nationalbank, are likely to provide the majority of banks with adequate liquidity buffers, even when the individual state guarantees expire, provided banks continue the positive trend of ensuring a better balance between their lending and deposits, as well as other private market-based funding.

Composition of banks' liquidity

The current requirements for banks' holdings of liquid assets are regulated by section 152 of the Financial Business Act. Assets which can be recognised as liquid assets include cash, mortgage-credit bonds, deposits with Danmarks Nationalbank and other banks, holdings of secure and liquid securities, as well as any credit commitments from central banks and banks. Figure 14 shows the composition of the liquid funds of Danish banks. The figure shows that banks' liquidity is primarily in mortgage-credit bonds.

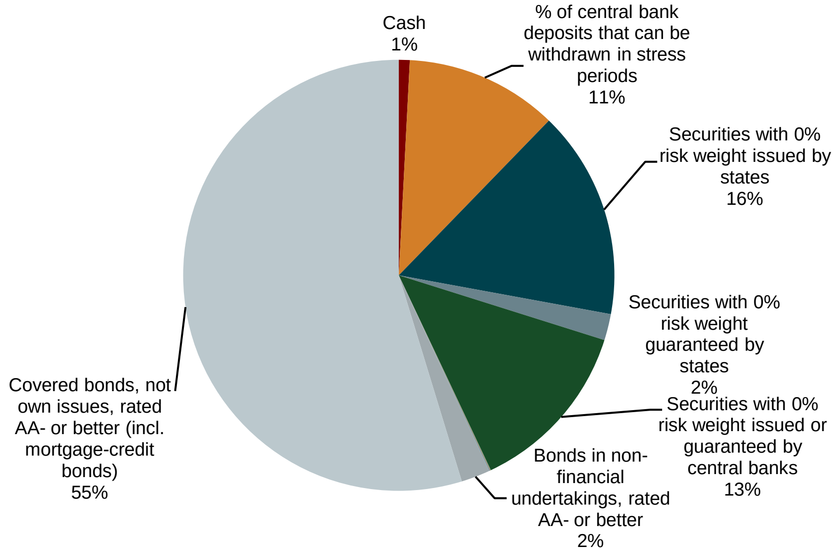
Figure 14: Liquid assets, all banks



Source: Reports to the Danish FSA

In comparison, figure 15 below shows the liquid funds held by group 1 banks, measured according to the forthcoming international Liquidity Coverage Ratio (LCR) standard. Like section 152, this standard contains several requirements on holdings of liquid assets.

Figure 15: Liquid assets distribution by LCR, group 1



Source: Reports to the Danish FSA.

In the original proposal by the Basel Committee, covered bonds (including Danish mortgage-credit bonds) could make up a maximum of 40% of banks' liquidity buffer, which represent a challenge to Danish banks. Figure 15 shows that covered bonds make up 55% of the total liquid assets of group 1 banks according to the preliminary 2010 LCR standard. Government bonds, that can be fully recognised in the LCR, represent 16% of the total liquid assets. For banks in the Basel countries, the distribution of liquid assets is opposite, such that the average holding of government bonds makes up 54% of liquid assets, while covered bonds comprise 9.4%.[14] The main reason for this situation is that the Danish mortgage-credit market is extremely well developed and very large in scope, even by international comparisons.

[14] EBA: "Results of the Basel III monitoring exercise as of 30 June 2011" EU group 1 and 2 banks.

5. About the statistics

This article on market developments has been based on financial statements etc. submitted for banks in Denmark. Figures are at bank level (i.e. not group level), unless otherwise stated.

This article focuses on developments in selected accounts items and financial ratios at sector level and on the underlying developments in the individual banks. At a later stage, the Danish FSA will publish "Statistical data for banks". This publication will contain more data from banks' submissions for 2011. Moreover, an update will follow of financial ratios in the five-year financial summary analysed by groups and the individual banks in the financial ratios database on the Danish FSA website.

All banks in groups 1-4 will be included in the statistics, unless otherwise stated. The four groups are composed on the basis of size by working capital, see appendix 6 which shows the group breakdown. The 91 banks in groups 1-3 cover 99% of the overall balance sheet total. Group 4 comprises 22 smaller banks.

6. Appendices

Appendix 1: Banks' financial statements 2007-2011

	Groups 1-4 in total						
						Annual change	
DKK millions	*2007*	*2008*	*2009*	*2010*	*2011*	*2007-2011*	*2010-2011*
Income statement							
Net interest income	42.898	53.142	69.739	58.900	51.535	4,7%	-12,5%
Dividends from shares etc.	1.340	910	691	802	890	-9,7%	11,0%
Net fee income	20.084	18.520	17.929	18.787	18.412	-2,1%	-2,0%
Net income from interest and fees	64.322	72.572	88.359	78.489	70.837	2,4%	-9,7%
Market value adjustments	7.036	-4.960	10.650	5.010	2.093	-26,1%	-58,2%
Staff and administrative expenses	43.127	46.384	47.611	46.540	48.123	2,8%	3,4%
Loan impairment charges etc.	-149	28.591	58.372	35.975	24.292	*	-32,5%
Income from associates and group undertakings	11.655	5.566	1.644	8.337	4.588	-20,8%	-45,0%
Profit before tax	39.787	-6.637	-15.579	4.136	3.586	-45,2%	-13,3%
Tax	7.116	-358	-80	2.454	1.624	-30,9%	-33,8%
Net profit for the year	32.670	-6.279	-15.499	1.682	1.963	-50,5%	16,7%
Balance sheet							
Due from credit institutions and central banks	727.332	552.879	574.016	564.315	498.453	-9,0%	-11,7%
Loans	2.144.448	2.276.653	1.983.690	1.953.603	1.786.351	-4,5%	-8,6%
Bonds	760.670	884.559	1.008.615	943.051	955.629	5,9%	1,3%
Shares, etc.	32.928	21.960	24.359	27.762	25.697	-6,0%	-7,4%
Due to credit institutions and central banks	1.266.663	1.177.805	852.785	766.992	797.922	-10,9%	4,0%
Deposits	1.623.014	1.681.996	1.657.958	1.627.502	1.625.561	0,0%	-0,1%
Issued bonds	448.792	585.472	676.851	634.380	500.427	2,8%	-21,1%
Total shareholders' equity	245.175	232.408	242.903	250.245	270.082	2,4%	7,9%
Total assets	4.285.683	4.733.260	4.324.022	4.287.394	4.306.671	0,1%	0,4%
Key figures (non-consolidated)							
Total capital ratio	12,3	14,3	17,8	17,9	20,1		
Tier 1 capital ratio	9,2	10,8	14,6	15,0	17,2		
Return on equity before tax	17,2	-2,8	-6,5	1,7	1,4		
Income/cost ratio	1,9	0,9	0,9	1,0	1,0		
Accumulated impairment ratio	0,6	1,6	3,3	3,9	3,6		
Impairment ratio	0,0	1,0	2,2	1,4	1,1		
Key figures (consolidated level)							
Total capital ratio	10,2	12,6	15,7	16,1	17,4		
Tier 1 capital ratio	7,5	9,4	12,7	13,4	14,9		

Note: * means that the calculation is not possible.

Note: Income statement and balance sheet figures are at non-consolidated level. From 2008 banks have submitted figures in accordance with the new solvency rules in Basel II. Figures are based on the banks which existed in the individual years. Banks taken over by the Financial Stability Company had impairment losses totalling DKK 741 mill. in 2011.

Source: Reports to the Danish FSA.

Appendix 2: Banks' financial statements by group 2010-1011

	Group 1			Group 2			Group 3			Group 4		
DKK millions	*2010*	*2011*	*Pct. change*	*2010*	*2011*	*Pct. change*	*2010*	*2011*	*Pct. change*	*2010*	*2011*	*Pct. change*
Income statement												
Net interest income	42.737	36.786	-14%	7.834	6.486	-17%	8.154	8.170	0%	109	93	-15%
Dividends from shares etc.	607	728	20%	95	74	-22%	97	87	-10%	1	1	0%
Net fee income	14.663	14.426	-2%	1.234	1.119	-9%	2.781	2.807	1%	73	60	-18%
Net income from interest and fees	58.007	51.940	-10%	9.163	7.680	-16%	11.031	11.064	0%	183	154	-16%
Market value adjustments	1.551	701	-55%	2.783	1.778	-36%	655	-379	-158%	10	-7	-170%
Staff and administrative expenses	30.953	33.328	8%	7.861	7.041	-10%	7.352	7.639	4%	140	116	-17%
Loan impairment charges etc.	21.028	16.118	-23%	9.549	3.579	-63%	5.262	4.571	-13%	39	23	-40%
Income from associates and group undertakings	8.078	3.516	-56%	615	252	-59%	-830	821	*	0	0	0%
Profit before tax	12.601	5.558	-56%	-5.357	-635	88%	-2.525	-1.339	47%	3	3	0%
Tax	2.656	2.233	-16%	-202	-99	51%	7	-513	-7429%	4	3	-25%
Net profit for the year	9.944	3.325	-67%	-5.155	-536	90%	-2.532	-825	67%	-2	0	*
Balance sheet												
Due from credit institutions and central banks	508.322	453.193	-11%	19.586	13.957	-29%	35.265	30.993	-12%	453	310	-32%
Loans	1.600.103	1.482.573	-7%	164.413	135.638	-18%	185.576	166.556	-10%	1.846	1.584	-14%
Bonds	817.821	849.435	4%	65.714	62.368	-5%	57.957	43.149	-26%	831	676	-19%
Shares, etc.	13.581	13.349	-2%	5.794	4.455	-23%	8.195	7.805	-5%	129	88	-32%
Due to credit institutions and central banks	691.223	747.283	8%	28.732	25.051	-13%	46.936	25.536	-46%	27	53	96%
Deposits	1.294.004	1.306.686	1%	151.719	140.464	-7%	177.249	176.226	-1%	2.758	2.185	-21%
Issued bonds	555.821	440.808	-21%	50.831	40.331	-21%	27.726	19.287	-30%	1	1	0%
Total shareholders' equity	184.054	204.036	11%	25.414	24.598	-3%	38.561	40.961	6%	580	486	-16%
Total assets	3.673.051	3.771.060	3%	288.265	253.347	-12%	317.441	279.460	-12%	3.484	2.804	-20%
Guarantees	425.440	318.722	-25%	26.620	20.183	-24%	41.346	34.315	-17%	401	251	-37%
Other liabilities	166.501	162.588	-2%	4.338	3.555	-18%	3.257	1.276	-61%	1	1	0%
Key figures (non-consolidated)												
Total capital ratio	17,98	20,39		14,31	15,45		20,06	22,17		23,54	25,65	
Tier 1 capital ratio	15,15	17,32		12,50	13,42		16,07	19,97		22,86	24,69	
Return on equity before tax	7,11	2,89		-21,21	-2,51		-6,74	-3,43		0,46	0,55	
Income/cost ratio	1,21	1,10		0,71	0,94		0,82	0,89		1,01	0,44	
Accumulated impairment ratio	2,66	3,12		10,55	6,11		6,86	5,77		4,03	4,06	
Impairment ratio	1,01	0,87		4,47	2,16		2,16	2,15		1,68	1,23	

Note: * means that the calculation is not possible.

Comparative figures take into account mergers as well as changes in the size of working capital which mean that a bank moves from one group to another. In other words, the groups are locked on the basis of the group allocation in 2011.

Source: Reports to the Danish FSA.

Appendix 3: Banks' key figures 2007-2011

	2007	2008	2009	2010	2011
Non-consolidated level					
Total capital ratio	12,28	14,30	17,84	17,90	20,09
Tier 1 capital ratio	9,20	10,84	14,55	15,02	17,24
Return on equity before tax	17,20	-2,80	-6,54	1,69	1,42
Return on equity after tax	14,14	-2,63	-6,53	0,67	0,74
Income/cost ratio	1,86	0,92	0,86	1,04	1,04
Interest rate risk	1,96	2,07	1,49	0,67	0,28
Loans and impairment losses over deposits	132,06	137,80	123,56	124,80	113,91
Excess coverage as a percentage of the liquidity requirement	101,34	82,78	163,41	160,23	127,25
Sum of large exposures	123,11	90,39	45,62	46,79	32,23
Accumulated impairment loss ratio	0,55	1,58	3,30	3,86	3,59
Annual impairmant loss ratio	-0,01	0,98	2,24	1,41	1,08
Growth in loans	25,67	5,83	-12,78	-0,06	-6,87
Gearing	8,81	9,58	8,19	7,63	6,65
Consolidated level					
Total capital ratio	10,23	12,63	15,72	16,12	17,42
Tier 1 capital ratio	7,54	9,35	12,65	13,39	14,85
Return on equity before tax	18,49	0,47	-2,75	2,25	2,25
Return on equity after tax	14,43	-0,40	-3,79	0,57	1,15
Income/cost ratio	1,73	1,01	0,94	1,05	1,06
Interest rate risk	2,38	2,58	1,79	0,89	0,44
Surplus liquidity in relation to statutory liquidity requirement	102,05	83,68	164,47	160,90	102,17
Sum of large exposures	134,00	103,23	49,93	53,14	23,32
Accumulated impairment ratio	0,36	0,93	2,41	2,93	2,53
Impairment ratio	-0,01	0,67	1,53	1,00	0,80
Growth in loans	19,44	5,87	-7,27	1,23	-3,96
Gearing	14,97	16,21	14,56	13,59	12,01

Note: Financial ratios are calculated on the basis of the banks which existed in the individual years.

Source: Reports to the Danish FSA.

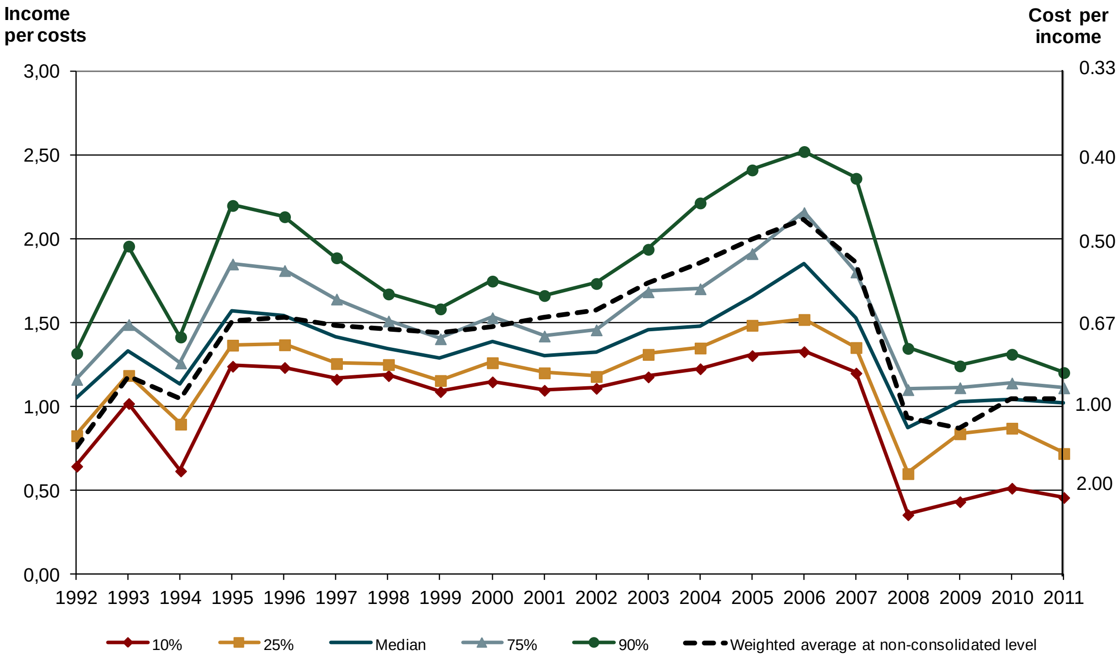
Appendix 4: Banks' capital and risk-weighted assets

	Group 1			Group 2			Group 3			Group 4		
DKK millions	*2010*	*2011*	*Pct. change*	*2010*	*2011*	*Pct. change*	*2010*	*2011*	*Pct. change*	*2010*	*2011*	*Pct. change*
Tier 1 capital	198.632	219.948	10,7%	26.801	23.780	-11,3%	38.611	41.176	6,6%	546	458	-16,1%
Solvency capital	235.983	258.883	9,7%	30.676	27.373	-10,8%	48.182	45.700	-5,2%	562	476	-15,3%
Risk-weighted assets	1.312.985	1.271.454	-3,2%	214.349	176.980	-17,4%	240.180	206.199	-14,1%	2.388	1.857	-22,2%
Total assets	3.673.051	3.771.060	2,7%	288.265	253.347	-12,1%	317.441	279.460	-12,0%	3.484	2.804	-19,5%
Tier 1 capital ratio	15,15	17,32		12,50	13,42		16,07	19,97		22,86	24,69	
Total capital ratio	17,98	20,39		14,31	0,00		20,06	22,17		23,54	25,65	

Source: Reports to the Danish FSA.

Appendix 5: Dispersion of financial ratios by fractiles

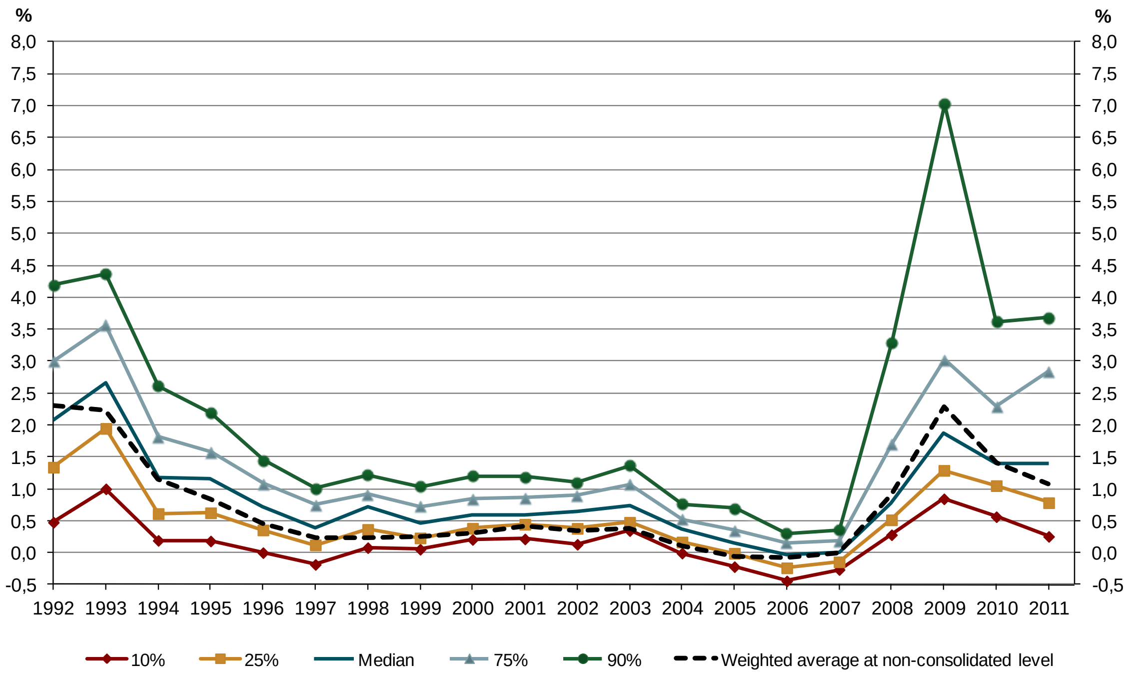
Figure A1: Income/cost ratio 1992-2011



Note: The right-hand axis shows the income/cost ratio; i.e. costs in DKK as a percentage of DKK earned. Therefore the same components are included in the calculation.

Source: Reports to the Danish FSA.

Figure A2: Annual impairment loss ratio 1992-2011



Source: Reports to the Danish FSA.

Appendix 6: Groups of banks 2011

FT.nr.	Name	FT.nr.	Name	FT.nr.	Name
Group 1 - Working capital over DKK 65 bn.		**Group 3 (continued)**		**Group 3 (continued)**	
2222	Nordea Bank Danmark A/S	6482	BRFkredit Bank a/s	9388	Sparekassen Djursland
3000	Danske Bank A/S	6520	Lollands Bank, Aktieselskab	9486	Sparekassen Østjylland
7858	Jyske Bank A/S	6771	Lægernes Pensionsbank A/S	9682	Nr. Nebel og Omegn, Sparekassen for
8079	Sydbank A/S	6850	Vestfyns Bank A/S	9684	Fanø Sparekasse
8117	Nykredit Bank A/S	6860	Nordfyns Bank, Aktieselskabet	9686	Den Jyske Sparekasse
10001	FIH Erhvervsbank A/S	6880	Totalbanken A/S	9690	Vorbasse-Hejnsvig Sparekasse
6		7230	Østjydsk Bank A/S	9695	Saxo Privatbank A/S
		7270	Aarhus Lokalbank Aktieselskab	9740	Frøs Herreds Sparekasse
Group 2 - Working capital over DKK 12 bn.		7320	Djurslands Bank A/S	9797	Broager Sparekasse
522	Sjælland, Sparekassen	7440	Nørresundby Bank A/S	9827	Sparekassen Bredebro
1149	Saxo Bank A/S	7500	Hvidbjerg Bank Aktieselskab	9860	Folkesparekassen
5201	Amagerbanken af 2011 A/S	7570	PenSam Bank A/S	13080	Frørup Andelskasse
5301	Arbejdernes Landsbank, Aktieselskab	7780	Skjern Bank, Aktieselskabet	13290	Andelskassen Fælleskassen
6160	FS Bank A/S	7790	Vinderup Bank, A/S	13330	Slagelse, Andelskassen J.A.K
7670	Ringkjøbing Landbobank, Aktieselskab	7890	Salling Bank A/S	13460	Merkur, Den Almennyttige Andelskasse
7681	Alm. Brand Bank A/S	7930	Kreditbanken A/S	74	
7730	Vestjysk Bank A/S	7990	Tønder Bank A/S		
9260	Sparbank A/S	8099	Nordjyske Bank A/S	**Group 4 - Working capital under DKK 250 mill.**	
9335	Kronjylland, Sparekassen	8222	Banque Internationale à Luxembourg	544	Refsnæs Sparekasse
9380	Spar Nord Bank A/S	8231	FIH Kapital Bank A/S	547	Arts Herred, Sparekassen for
11		8269	Carnegie Bank A/S	579	Sparekassen Den lille Bikube
		9020	Sparekassen Hvetbo A/S	800	Flemløse Sparekasse
Group 3 - Working capital over DKK 250 mill.		9044	Dronninglund Sparekasse	5125	Leasing Fyn Bank
400	Lån og Spar Bank A/S	9070	Sparekassen Vendsyssel	9121	Boddum-Ydby Sparekasse
537	Dragsholm Sparekasse	9090	Thy, Sparekassen	9143	Hunstrup-Østerild Sparekasse
631	Kongsted Sparekasse	9100	Fjordbank Mors af 2011 A/S	9228	Vokslev Sogns Spare- og Laanekasse
644	Fanefjord Sparekasse	9116	Sparekassen Limfjorden	9357	Helgenæs Sparekasse
681	Lolland A/S, Sparekassen	9124	Sønderhå-Hørsted Sparekasse	9358	Vistoft Sparekasse
755	Middelfart Sparekasse	9133	Frøslev-Mollerup Sparekasse	9369	Søby-Skader-Halling Sparekasse
828	Sparekassen Faaborg A/S	9135	Klim Sparekasse	9627	Ulfborg Sparekasse
844	Svendborg Sparekasse A/S	9137	Ekspres Bank A/S	9629	Stadil Sparekasse
847	Rise Spare- og Lånekasse	9144	Bank DNB A/S	9634	Borbjerg Sparekasse
1671	Basisbank A/S	9174	Farsø, Sparekassen	9639	Fjaltring-Trans Sparekasse
1693	Cantobank A/S	9212	Hals Sparekasse	13070	Faster Andelskasse
5999	Danske Andelskassers Bank A/S	9217	Himmerland A/S, Sparekassen	13100	Københavns Andelskasse
6060	DiBa Bank A/S	9261	Skals, Sparekassen i	13220	Andelskassen OIKOS
6070	Max Bank A/S af 2011	9283	Langå Sparekasse	13240	Ebeltoft, Andelskassen J.A.K
6100	Skandinaviska Enskilda Banken A/S	9307	Spar Salling Sparekasse	13350	Østervraa, J.A.K. Andelskassen
6140	Møns Bank, A/S	9312	Sparekassen Balling	13370	J.A.K. Andelskassen Varde
6220	Vordingborg Bank A/S	9351	Hobro, Sparekassen	13450	Funder Fælleskasse Andelskasse
6471	Grønlandsbanken, Aktieselskab	9354	Rønde og Omegns Sparekasse	22	

Note: Working capital consists of: Deposits, issued bonds, etc., subordinated debt and equity.

Source: Danish FSA

Mergers in 2011			
Discontinuing banks		**Continuing banks**	
9201	Midtfjord, Sparekassen	9217	Himmerland A/S, Sparekassen
6610	EIK Bank Danmark 2010 A/S	681	Lolland A/S, Sparekassen
13000	Lunde-Kvong Andelskasse	9682	Nr. Nebel og Omegn, Sparekassen for
12000	Sammenslutningen Danske Andelskasser	5999	Danske Andelskassers Bank A/S
9501	Fruering-Vitved Sparekasse	7230	Østjydsk Bank A/S
9377	Sparekassen Midtdjurs	9388	Sparekassen Djursland
13020	Ryslinge Andelskasse	828	Sparekassen Faaborg A/S
824	Nova Bank Fyn A/S (Finansiel Stabilitet)	6160	FS Bank (Finansiel Stabilitet)
6160	Roskilde Bank, A/S (Finansiel Stabilitet)	6160	FS Bank (Finansiel Stabilitet)
9080	ebh Bank A/S (Finansiel Stabilitet)	6160	FS Bank (Finansiel Stabilitet)

Financial Stability Company	
5201	Amagerbanken af 2011 A/S
9100	Fjordbank Mors af 2011 A/S
6070	Max Bank A/S af 2011

Mergers in 2012			
Discontinuing banks		**Continuing banks**	
9116	Sparekassen Limfjorden	9070	Sparekassen Vendsyssel
9174	Farsø, Sparekassen	9686	Den Jyske Sparekasse
7270	Aarhus Lokalbank Aktieselskab	7730	Vestjysk Bank A/S
547	Arts Herred, Sparekassen for	537	Dragsholm Sparekasse
9486	Sparekassen Østjylland	9335	Kronjylland, Sparekassen
9307	Spar Salling Sparekasse	9686	Den Jyske Sparekasse

Financial Stability Company	
9486	Sparbank Østjylland af 2012

Source: Danish FSA

Appendix 7: Bank Packages IV and V

Bank Package IV

Called "consolidation initiatives" and contains the following four main elements:

1. The first element changes the banks' payments to the Guarantee Fund for Depositors and Investors (the Fund). In future banks will pay an annual contribution. The change implies a more even and predictable payment to the Fund. The Fund will continue to be fully financed by the sector.
2. The second element is extension of the compensation scheme which should give banks more incentive to take over all or part of a bank in distress. If a healthy bank takes over all of a bank in distress, in addition to compensation from the Fund, the bank will be able to receive compensation from the Financial Stability Company, provided that the bank has state-guaranteed deposits or issues. Alternatively, a bank may only take over the healthy part of a bank in distress. In this case, the unhealthy part will be taken over by the Financial Stability Company with a guarantee from the sector to cover losses.
3. The third element deals with systemically important financial institutions (SIFIs). International work is aiming at setting tighter regulations for SIFIs, and Denmark has set up an expert committee to select a number of Danish SIFIs. These will be subject to tighter requirements than other banks and mortgage-credit institutions. It is expected that the committee will publish its report before the end of 2012.
4. The final element includes a scheme in which, up to the end of 2013, banks can apply for individual state guarantees to replace current guarantees, if two banks want to merge and at least one of the banks is in distress or is expected to become in distress, and where the continuing bank is sustainable.

Bank Package V

Called the "development package with initiatives to promote financing of small and medium-sized enterprises in particular". The package includes three elements:

1. Scheme to split loans portfolio.
   Division of FIH bank to separate a large property-related loans portfolio. The Financial Stability Company entered into an agreement with FIH to take over property exposures totalling about DKK 16 bn. In 2009 and 2010, the FIH received individual state guarantees totalling DKK 42 bn. The loans fall due in 2012 and 2013 and they are a significant funding challenge for FIH. Managing repayment of the state-guaranteed loans through settlement of existing loans will involve greatly slimming the current balance sheet and this will be difficult to do without negative knock-on effects on other banks, borrowers etc. In order to avoid these undesirable effects, the Financial Stability Company will take over a property-related loans portfolio of about DKK 16 bn. from FIH. FIH will place a guarantee that the Financial Stability Company will not suffer a loss through this arrangement.
2. Establishment of a financing institute for agriculture (LFI) in order to provide financially sustainable agriculture with better opportunities to procure financing. LFI is to receive agriculture exposures which, in their assessment, are financially sustainable from the Financial Stability Company and other banks. Establishment of LFI will take place in cooperation between the financial sector, the agriculture and food sector, the Financial Stability Company and DLR (a mortgage bank for agriculture).
3. Enhancement of growth and export financing.