March 2007
IMF Country Report No. 07/118

Denmark: Financial Sector Assessment Program—
Detailed Assessment of Observance of the Basel Core Principles

This Detailed Assessment of Observance of the Basel Core Principles for Denmark was prepared by a staff team of the International Monetary Fund as background documentation to the Financial Sector Assessment Program with the member country. It is based on the information available at the time it was completed in September 2006. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Denmark or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623 7430 ● Telefax: (202) 623 7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

FINANCIAL SECTOR ASSESSMENT PROGRAM

DENMARK

DETAILED ASSESSMENT OF OBSERVANCE OF THE BASEL CORE PRINCIPLES

SEPTEMBER 2006

INTERNATIONAL MONETARY FUND
MONETARY AND FINANCIAL SYSTEMS DEPARTMENT

Contents Page

GLOSSARY

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AO	Accountable officer
BIS	Bank for International Settlements
BCP	Basel Core Principles for Effective Banking Supervision
CP	Core principle
DFSA	Finanstilsynet, the Danish Financial Supervisory Authority
DGF	Danish Guarantee Fund
DNK	Danmarks Nationalbank
EEA	European Economic Area
EO	Executive orders
EU	European Union
DSC	Danish Securities Council
FATF	Financial Action Task Force
FBA	Financial Business Act
FBC	Financial Business Council
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
IAS	International Accounting Standards
IASB	International Accounting Standard Board
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IT	Information technology
MFD	Monetary and Financial Systems Department of the IMF
MoEBA	Ministry of Economics and Business Affairs
MoU	Memorandum of understanding
NAO	National audit office

I. Introduction

A. General

1. The assessment of the observance of the *Basel Core Principles for Effective Banking Supervision* (BCP) developed by the Basel Committee on Banking Supervision was carried out as part of the first Financial Sector Assessment Program (FSAP) mission to Denmark during the period November 7–18, 2005.[1] It is the first external assessment of the banking supervision system in Denmark.

2. The Danish Financial Supervisory Authority (DFSA) cooperated fully with the assessment team and provided extensive clarifications in the form of documents and oral explanations. The DFSA's assistance is gratefully acknowledged.

Information and methodology used for assessment

3. The DFSA was requested to complete a self-assessment of the BCP and a questionnaire in advance of the mission. The responses to the questionnaire and self-assessments were made available to the assessors in advance of the mission and were clarified in discussion with the authorities and market participants. The assessors reviewed additional documents made available in advance of the mission, spent several days interviewing representatives of the DFSA, as well as commercial bankers, accountants, and other market participants, in order to clarify and/or verify the facts contained in the questionnaire responses.

4. The assessment of the observance of each of the Core Principles (CP) follows a qualitative approach and is based on the *Core Principles Methodology Document* of October 1999. The assessment method consisted of examining the degree of observance of each of a principle's essential criteria and, where the assessors judged necessary, of the additional criteria, as well. In addition to the responses to the questionnaire, detailed information available on the DFSA's website facilitated the drafting of this report. The assessors were able to focus their discussions and verify provisions of the Financial Business Act (FBA), which, in its latest version, entered into force on June 21, 2005, as well as executive orders and guidelines, which elaborate on the provisions of the FBA. Follow-up questions were raised with DFSA staff and supplemental information was provided to the assessors as necessary.

5. A separate MFD/Legal Department (LEG) team of the IMF will assess Denmark's compliance with the FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). A new AML/CFT law has been adopted in early 2006, but will only be effective by end-2006, since financial institutions need time to

[1] This assessment was carried out by Peter Hayward (formerly, Bank of England) and the Monetary and Capital Markets Department (MCM) of the International Monetary Fund (IMF), and Stefan Spamer (Deutsche Bundesbank).

implement the new procedures. The findings of this mission will be included in the Financial System Stability Assessment (FSSA). This assessment is based solely on the criteria for BCP 15 in the 1999 methodology.

6. A principle will be considered compliant whenever all essential criteria are generally met without any significant deficiencies. There may be instances where a country can demonstrate that a principle is observed through different mechanisms. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the principle and, therefore, other measures (including any additional criteria) may also be deemed necessary by the assessor to judge that compliance is achieved. A principle will be considered largely compliant whenever only minor shortcomings are observed, which do not raise any concerns about the authority's ability and intent to achieve full compliance with the principle within a prescribed period of time. A principle will be considered materially noncompliant whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle will be considered noncompliant whenever no substantive progress toward compliance has been achieved. A principle will be considered not applicable whenever, in the view of the assessor, the CP does not apply given the structural, legal, and institutional features of a country.

Institutional and macroprudential setting, market structure overview

7. The Danish financial sector is deep (total assets are equal to close to five times GDP) and sophisticated, with some internationally unique financial instruments (mortgage bonds). Since the deregulation of the 1970–1980s, the business lines of firms in the financial sector have expanded. While some financial activities may not be carried on within a bank (for example, insurance activities), it is possible for a bank to enter the insurance and other businesses through subsidiaries and associated companies. Banks may also form holding companies and other group structures As a result, there have been a number of mergers, and group formations, as well as some break-ups in the last two decades.[2]

Credit institutions

8. At end-2005, total assets of credit institutions were around 332 percent of GDP. Currently, there are 170 credit institutions registered in Denmark, of which 161 are commercial banks, 8 are mortgage banks, and 1 is a specialized bank.[3] Commercial banks include savings banks and cooperative banks, which are governed by the same legislation.

[2] For a comparison of the Danish financial system with the euro area, see, for instance, *Det Danske Finansielle System—En Sammenligning med Eurolandene* by Jesper Berg and Christoffer Kok Sørensen, Danmarks Nationalbank's Working Papers 2005-23, Danmarks Nationalbank, Copenhagen, December 2004.

[3] The specialized *Danmarks Skibskreditfond* has traditionally been involved in the long-term ship financing to both Danish ship-owners and customers of Danish shipyards. The size of this institution is relatively small (assets are equivalent to 4 percent of GDP).

There are many small banks in Denmark. Many use common information technology (IT) service centers, which they may own. The two largest banking groups—Danske Bank and Nordea Danmark—account for more than 50 percent of the commercial bank lending.[4] The five largest banking groups account for about 80 percent of total loans (71 percent if foreign branches are excluded). There is thus a substantial concentration in spite of the high number of institutions. Comparisons of some of the ratios of commercial banks with banks in other countries warrant some caution, since the bulk of secured housing finance in Denmark is conducted by the specialized mortgage credit banks. Most of them are linked to commercial bank groups.

9. Commercial banks are profitable. In 2005 (2004), the return on equity before tax for the sector as a whole was 21¼(17¾) percent. In 2005 (2004), the average capital adequacy ratio was almost 13¼ (13½) percent, with the smaller banks typically having a larger ratio. During 2004 and 2005, bank lending has increased rapidly, while the loan to deposit ratio is now over 100 percent.[5]

Mortgage financing

10. Danish mortgage financing has been governed by special legislation, which allows specialized mortgage credit banks to fund mortgages with collateralized mortgage bonds. With total assets close to 134 percent of GDP, the Danish mortgage banks are slightly smaller than the Danish commercial banks.[6] The mortgage banking sector is dominated by two institutions—Nykredit and Realkredit Danmark—which account for more than 70 percent of new gross lending. Nykredit owns a bank. Realkredit Danmark is part of Den Danske banking group—the largest Danish banking group.

11. Mortgage banks are profitable, but less profitable than commercial banks reflecting special legal requirements reducing their risks. In 2005 (2004), mortgage banks reported profits before tax of almost 11 (9⅓) percent on equity (respectively 0.6 and 0.5 percent on assets). Loan losses have long been very modest. In 2005 and 2004 they were even negative for some banks due to revocation of previous provisions. In recent years, the most significant development has been the trend toward variable mortgage rates. In 2000, such loans accounted for less than 10 percent of mortgage loans, but in 2005 they accounted for almost half of new loans. Furthermore, mortgage loans with deferred repayment for a specified period has been increasing.

---

[4] Danske Bank's Danish operations form the hub of a predominantly Scandinavian group, with solid market shares in Sweden and Norway. Nordea Danmark is the Danish segment of the pan-Nordic Nordea Group, which straddles the region and includes four well-established banks in Finland, Sweden, Norway, and Denmark.

[5] See separate technical note on the stress testing of the banking system.

[6] In 2004, assets amounted to 144½ percent of GDP, but the decline is due to a change in the accounting rules.

Supervisory structure

12. Financial sector stability is a shared responsibility of the Danmarks Nationalbank (DNB) and the DFSA. The DFSA is responsible for overseeing the various financial institutions and the regulation of investment business, while the responsibility for payment systems is shared with the DNB. The latter's authority is derived from the DNB law of April 7, 1936 (Section 1): which requires the DNB to "maintain a safe and secure currency system in this country, and to facilitate and regulate the traffic in money and the extension of credit."

13. With a view to anchor coordination and avoid duplication, a coordination committee on financial stability has been established. It is chaired by the permanent secretary of the ministry of economics and business affairs (MoEBA). It meets every six months and when needed. The DNB and the DFSA are faced with a broader range of operational tasks and have also concluded a separate agreement. The pragmatic approach to good coordination was most recently confirmed in May 2005 by a memorandum of understanding (MoU) concerning financial supervision between DNB, the Danish Ministry of Finance, the Danish MoEBA, and the Danish Financial Supervisory Authority.[7]

14. The DFSA is accountable to the minister of economics and business affairs, with whom the director general agrees on an annual performance contract, but much of its work is under the jurisdiction of independent councils established under the FBA. The DFSA has authority to impose sanctions on breaches of regulation under its authority. However, all matters of principle or issues that are of significant importance for an institution are decided by the financial business council (FBC), which covers financial companies and holding companies, and the Securities Council, which covers securities regulation. In addition a pension market council has been established to ensure an open debate about pension fund issues. These councils include representatives from the industry, but only as a minority, and independent members with special expertise. This structure was established to ensure that decisions on individual cases are taken independent of the MoEBA. The minister has no authority to issue instructions to the DFSA except on certain legislative and regulatory matters, but can ask it to examine specific matters. The DFSA can and must ask for an additional mandate from the MoEBA, if it feels that it is beneficial to exceed its standard supervisory authority. A case in point would be facilitating a merger or takeover with a view to avoid bankruptcy of a financial institution. The DFSA, however, is required to inform the MoEBA about "any matters of great political or social importance."

15. The DFSA's mission is to create future oriented conditions for growth in an increasingly globalized world, and by preserving confidence in the Danish financial sector. During 1970–1980s, the financial sector was deregulated and financial conglomerates emerged. In 1988, supervision of insurance companies and in 1990 of mortgage banks was

---

[7] For details, see *Monetary Review*, 2nd Quarter 2005, DNB, Copenhagen (available on: http://www.nationalbanken.dk/).

moved to the DFSA. In 1994, political responsibility for mortgage banks was moved from the ministry of housing to the ministry of economics. In November 2001, the ministry of economics and the ministry of business affairs were merged. The tasks of the DFSA are specified in the annual budget laws, the FBA, as well as other laws specifying rights and responsibilities for financial firms supervised by the DFSA. The agency oversees financial holding companies, banks (including savings banks and cooperative banks), mortgage credit banks (all of which are credit institutions in European Union (EU) terminology), life insurance and pension funds, nonlife insurance companies, insurance brokers, mutual funds, and is responsible for securities regulation.

16. In addition to regulation and supervision, the DFSA also has an obligation to monitor developments in the industry. A risk-based supervisory approach is applied. Assessments based on off-site reporting as well as additional information available to the supervisor are used to prioritize the on-site examination schedule. Firms with larger risks are subject to intensified supervision, often involving more frequent reporting. Large institutions are subject to comprehensive examinations over a four year cycle, medium-sized institutions are examined at least every four years, while smaller low-risk institutions are examined every seven years. In the large banking groups, at least one risk area is inspected each year and the DFSA meets at least annually with their management. The regulatory work includes preparing laws and regulations as well as international work, including EU coordination. Transparency is facilitated by comprehensive annual reports on the DFSA's activities. Statistical information, including average performance indicators, which facilitates peer reviews is published.[8]

17. A recent audit by the national audit office (NAO) found that further improvements, especially supervision of non-life insurance, should be made.[9] Specifically, the NAO noted that frequency of comprehensive on-site inspections needed to be shortened and supervision of IT systems needed to be upgraded, and the follow-up of inspections made more effective. The NAO suggested the sample size of the loan portfolio to be reviewed should be reduced if the bank's own provision policies seemed adequate and appeared to be implemented.

18. The DFSA must review its resource needs and prioritization in light of continuing new challenges. The DFSA has staff equivalent to 181 full time positions. Reportedly, the DFSA attracts qualified applicants, but many experienced supervisors seek employment in the private sector. Although the costs are fully borne by the supervised institutions, revenues and costs are included in the fiscal budget and hence approved by the legislature. The adoption of International Financial Reporting Standards (IFRS) and the implementation of Basel II may well reduce the capital cushion of many banks and hence demand closer

---

[8] Comprehensive information on the financial system is available on the Danish Financial Supervisory Authority's website: http://www.ftnet.dk/sw99.asp .

[9] The report was published in September 2005 on http://www.rigsrevisionen.dk/, but is only available in Danish. It covered the period 2001–04, but with the focus on the supervision of small and medium-sized banks and non-life insurance companies during the period 2003–04.

monitoring, which will be resource-demanding. Furthermore, new AML/CFT legislation may also affect the resource use.

19. Denmark has a deposit insurance system, the Danish Guarantee Fund (DGF) for depositors and investors, which covers deposits of up to DKr 300,000 per depositor. Certain special categories of deposit are, however, covered in full. Membership is compulsory for all credit institutions. The DGF is managed by a board appointed by the minster for economics and business affairs and is supervised by the DFSA. Foreign bank branches can, if their national coverage is not at level with the Danish system, buy add-up insurance in the DGF.

Preconditions for effective supervision

20. The preconditions for effective supervision are largely in place. As a member of the EU since 1973, EU directives have been adopted and implemented in financial legislation. This has in case of commercial banks resulted in less strict capital requirements. The payments systems are effective and reliable. Contracts are readily enforceable and banks report no problems in realizing security. The external audit function is effective and to international standards. The public governance framework is basically sound. In 2005, Denmark was listed as the fourth most favorable on anti-corruption, just below Iceland, Finland, and New Zealand, based on the *2005 Corruption Perception Index* published by *Transparency International*.[10]

21. IFRS were adopted for all listed companies and by all financial enterprises, effective January 2005. This has resulted in a decline in provisions by many banks. The authorities describe the change as moving from a conservative provisioning policy to a neutral provisioning policy. Joint stock companies and limited liability companies are required to submit audited financial statements to the company registrar.[11]

22. The authorities have taken steps to improve corporate governance and disclosure. In 2001, the Nørby Committee was established to make recommendations on measures to improve corporate governance. The Nørby Committee decided to make specific Danish recommendations instead of using international standards—such as the *OECD's Principles of Corporate Governance*. This was perceived as the best way to ensure flexibility and diversity of different business types and ownership structures, which characterize Danish companies. The Nørby Committee's recommendations seek voluntary compliance, although listed companies that do not implement any of the recommendations are now obliged to explain why they may deviate in their annual reports to shareholders.

---

[10] See http://www.transparency.org/surveys/index.html#cpi .

[11] This information has been used by DNB to develop its corporate failure model, which it uses to monitor financial stability.

Summary of the Core Principles Assessment

23. Objectives, autonomy, powers, and resources (CP 1): The basic legal framework is contained in the FBA, and in executive orders and explanatory guidelines issued pursuant to the FBA.[12] These provide powers for the DFSA to supervise all financial institutions. The DFSA is the sole authority responsible for supervision of the financial sector. Therefore, a defined mechanism for coordinating supervision of different types of institutions is not needed. The DFSA has a range of remedial measures and sanctions at its disposal to ensure effective supervision, while cases with serious breaches of certain prudential regulation are transferred to the police. There is no visible evidence of any undue government or industry interference in the work of the DFSA.

24. The DFSA, however, is an institution for which the minister of economic and business affairs is responsible to parliament. This could conceivably impede the DFSA's autonomy, because it could not be excluded that thminister of economics and business affairs might overrule decisions made by the DFSA on the advice of the FBC with regard to the issuance of executive orders. The MoEBA could, for example, instruct or influence the work of the DFSA by proposing new legislation against the advice of the DFSA. While in general it is not usual for agencies in the public sector to be established by law, such a law could ensure the DFSA's role as an autonomous supervisory authority and would make the agency's position more transparent.

25. Although the DFSA also has, in general, adequate freedom to deploy its banking supervision resources, the DFSA's budget is incorporated into the overall budget of the government and subject to passage of the annual Finance Act.

26. Legal protection for supervisors is currently not provided for in specific legislation but general legislative arrangements ensure that staff are protected against law suits while discharging their duties in good faith.

27. Licensing and Structure (CPs 2-5): The FBA defines clearly the term "bank" and permissible activities of banks. In the licensing process, the applicant has to inform the DFSA of all relevant information (fitness and propriety of members of the Board of Directors and of the Board of Management, as well as the suitability of shareholders). Under the FBA, the DFSA has authority to grant authorization for acquisitions or increases of qualifying holdings. Investments in other companies, that are not credit institutions, financial institutions or ancillary banking undertakings, are restricted to a total amount of 100 percent of the liable capital and additional restrictions limit individual investments.

28. Prudential regulation and requirements (CPs 6-15): Rules and regulation regarding capital adequacy conform to the Capital Accord of the Basel Committee on Banking

[12] The legislation and prudential regulation for banks does not automatically cover the Faeroe Islands and Greenland. The legislation and regulation is entered into force separately in these parts of the country approximately one year after the changes enter into force in Denmark.

Supervision. Under Sections 170 and 172/2 of the FBA, capital adequacy ratios are calculated on both a consolidated basis for banking groups and on a solo base for banks within a group. The solvency ratio requirement also applies to bank holding companies. Denmark has implemented the European Parliament and Council Directive 2000/12/EC, and Council Directive 93/6/EEC on the Capital Adequacy of Investment Firms and Credit Institutions. The FBA Section 124 states, that the base capital of banks and mortgage-credit institutions shall constitute no less than 8 percent of the risk-weighted items (the solvency requirement) and should be maintained at all times.

29. Methods of on-going supervision (CPs 16-20): The DFSA relies mainly on on-site inspection of banks supplemented by analysis of periodic reporting. The DFSA also relies on the work of internal and external auditors who are obliged to provide reports on their work to ensure the accuracy of off-site reporting. Large banks are inspected under a four year cycle which covers all the principal areas of risk. This means in practice that supervisors do on-site work in the banks at least once a year but often more frequently. Smaller banks are inspected once every four years unless they are considered vulnerable. Very small banks posing minimal risk are inspected only once every seven years. All banks are subject to off-site reporting requirements and the resulting data is analyzed on at least a quarterly basis. Annual assessments are made and the consequent ratings are used to ensure that high risk banks are prioritized in the on-site examination schedule.

30. Information requirements (CP 21): Banks are now required to comply with IFRS. The DFSA has the power to dismiss external auditors and appoint additional auditors. External audit obligations are set out by the DFSA. Supervisors see reports prepared by internal and external auditors and these contain information specifically required by the supervisors.

31. Formal powers of supervisors (CP 22): The DFSA has a range of sanctions from informal warnings, through the power to give directions, additional capital requirements, to the suspension of payments and the appointment of a conservator, and, ultimately to the revocation of the license. However, serious cases of breaches of certain prudential regulation are transferred to the police.

32. Cross-border banking (CPs 23-25): The FBA provides the DFSA with the means to conduct the supervision of credit institutions on a consolidated basis. The DFSA may request information and documents from foreign banks and financial market supervisory authorities and has the authority to undertake direct inspections in foreign establishments of banks. Banks are required to obtain the DFSA's approval before they establish a subsidiary or branch outside Denmark. The DFSA can withdraw the license of the bank, but has no direct authority to require the closing of overseas offices. The DFSA has signed MoUs with several relevant supervisory authorities and has regular meetings with these authorities, particularly in connection with on-site inspections. Since 2000, the Nordic supervisory authorities have operated a cooperation agreement on the supervision of the Nordea Group. Foreign banking institutions are subject to similar regulatory requirements applicable to all other banks operating in Denmark. The current legal provisions give the DFSA powers to access any information on a subsidiary of a foreign banking institution in Denmark. The DFSA has

powers to share information needed by the home country supervisors for the purpose of carrying out consolidated supervision. The DFSA does not formally require, before issuing a license, approval (or notice of non-objection) from the home supervisor. In addition, the DFSA does not formally assess whether the home country supervisor practices consolidated global supervision.

Table 1. Detailed Assessment of Compliance of the Basel Core Principles

Principle 1.	**Objectives, Autonomy, Powers, and Resources** An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	The FBA (Consolidated Act no. 613 of June 21, 2005) provides the statutory and legal framework for banking supervision. The DFSA was established in 1998 as an integrated financial supervisor and one of its tasks is the supervision of the banking sector. Section 344 of the FBA specifies the responsibility of the DFSA as follows: **(1)** The DFSA shall supervise compliance with this Act and regulations laid down pursuant to this Act except for section 77(1) and (2). The Danish Commerce and Companies Agency shall, however, supervise compliance with section 15(1), (2) and (4) and sections 83, 87, 91 and 112. These sections deal with company incorporation and registration matters. The Danish Securities Council shall, together with the Danish FSA, ensure that the regulations regarding financial information in annual reports and interim reports laid down in sections 183-193 and in regulations laid down in pursuance of section 196 are observed by financial undertakings that have issued securities admitted for listing or trading on a stock exchange, or whose securities are traded on an authorized market place, cf. section 83(2) and (3) and section 83b of the Securities Trading, etc. Act. In this connection, the Danish Securities Council shall perform the authorities laid down in section 197. **(2)** For branches of credit institutions licensed in another country within the European Union or in a country with which the Community has entered into agreement for the financial area, the Danish FSA shall, in accordance with provisions laid down in EU Directives, supervise liquidity in such branches. **(3)** If a bank, a mortgage-credit institution, an investment company or an investment management company is a subsidiary company of a credit institution, an investment firm or a management company with a registered office in another country within the European Union or another country with which the community has entered into an agreement for the financial area, the DFSA may, upon agreement, transfer responsibility for supervision of the solvency and major exposures of the bank, mortgage-credit institution, investment company, investment management company or group to the authority which carries out consolidated supervision of the foreign parent undertaking.

	(4) The DFSA may, in special cases, utilize foreign assistance. **(5)** The minister for economic and business affairs may lay down more detailed regulations for the procedures of the DFSA in accordance with the provisions laid down in community law. The Danish regulatory policies are formulated on three levels. At the first level all laws, such as the FBA, are proposed to parliament by the minister of economic and business affairs. The DFSA has substantial influence in the drafting of the laws. At the second level on more technical policy, the DFSA has, under various provisions of the FBA, powers to issue prudential regulations in the form of executive orders (EOs). In addition, the DFSA issues guidelines as necessary, which complete the framework of prudential standards that banks must meet. The FBA is regularly amended. The main legislation concerning banking supervision—which is available on the DFSA's website[13]—includes: • The FBA—Consolidated Act No. 613 of June 21, 2005 • Guarantee Fund for Depositors and Investors Act—Consolidated Act No. 1066 of December 10, 2003 • Mortgage-Credit Loans and Mortgage-Credit Bonds Act—Act No. 454 of June 10, 2003 **Executive Orderss**: • EO on valuation by properties by Mortgage Banks – (262 of April 12, 2005). • EO on capital adequacy – (9712 of December 22, 2004). • EO on the rules of Procedure for the Financial Business Council – (1363 of December 15, 2004). • EO on Large Exposures – (1487 of December 13, 2004). • EO on Pension Pools and other Tax-Privileged Savings. (1160 of November 29, 2004). • EO on Intra-Group Transactions – (904 of September 1, 2004). • EO on Reporting of Large Exposures for Groups where the Parent Company is a Financial Holding Company or a Financial Undertaking Full Consolidated Statements are not Prepared – (793 of July 10, 2004). • EO on Choice of Law, with regard to suspension or compulsory composition, compulsory dissolution or bankruptcy of banks mortgage-credit institutions and electronic money institutions – (674 of June 24, 2004). • EO on Funding, the Balance Principle, Interest Rate Risk and Liquidity Risk of Mortgage Banks – (1190 of December 17, 2003). • EO on Auditing Financial Undertakings and Financial Groups – (1183 of December 15, 2003). • EO on the Guarantee Fund for Depositors and Investor – (1055 of December 8, 2003). • EO on the instruments and contracts, in addition to those mentioned in annex 5 of the FBA, with which banks and investment companies may carry out services – (984 of December 5, 2003). • EO on Good Business Practice for Financial Undertakings – (604 of June 26, 2003). • EO on the Collaboration between the Danish Financial Supervision Authority and a Guarantee Fund for Depositors and Investors – (92 of February 19, 2002).

[13] Click on: http://www.ftnet.dk/sw1279.asp .

	Guidelines: • Consultative Guidelines no. 9377 of June 30, 2005. Calculation of Solvency Need – Consultative Guidelines in accordance with sections 124(3) and 125(5) of the FBA. • Guidelines on IT control and security measures. • Guidelines no. 9040 of January 12, 2005 for Banks pursuant to section 71(2) of the FBA (A similar Guidelines for Mortgage Banks is about to be issued). As a long-standing member of the EU, Denmark has implemented all relevant EU Directives regulating the banking sector. The provisions of the FBA cover the monitoring of banks' conformity with laws, observance of compulsory prudential ratios and regulations and, within its jurisdiction, measures necessary to ensure adherence to laws, norms, and regulations. The FBA lays down the framework of minimum prudential standards that banks must meet. Under section 344 of the FBA, the DFSA is responsible for banking supervision in Denmark. It is the sole authority for carrying out banking supervision for banking institutions and mortgage banks licensed under this Act. Therefore, a defined mechanism for coordinating actions between entities responsible for banking supervision is not necessary. The DFSA cooperates with the MoEBA and with DNB. An MoU on general cooperation between DNB and the director general of the DFSA regarding financial surveillance is in place. It ensures cooperation in relevant areas, including statistics. If a bank does not meet the requirements in the FBA or other relevant laws, the DFSA has powers to order the bank to do so. In cases of material noncompliance the DFSA may, subject to approval by the FBC, withdraw the license of the bank (see CP 22). There is no legal basis to force a problem bank to merge with another institution. In these situations, the DFSA can seek a mandate from the minister of economic and business affairs. Such a request has never been denied. On this basis and within the limits of this mandate, the DFSA participates in "orderly resolution of a bank with problems." According to the FBA, Section 353, the DFSA reports to the MoEBA on its activities at least on an annual basis. The DFSA has a strategic plan, which is renewed when appropriate or at least every third year. The strategic plan is part of a yearly performance contract that the DFSA enters into with the MoEBA. In this contract the objectives that the DFSA aims to achieve are set out for the coming year. This performance contract and the above mentioned report are subject to public disclosure and can be viewed on DFSA's website.[14] The director general and the senior management of the DFSA do not participate in plenary sessions of the parliament. In general, the DFSA communicates with the parliament via the minister of economic and business affairs, who is responsible for introducing legislation on supervisory matters. Under Sections 183, 196, and 197 of the FBA, the DFSA ensures that all banks under its jurisdiction provide audited annual reports. The DFSA lays down the form, extent, and deadlines for publication. The DFSA frequently publishes relevant information on the financial strength and performance of the industry. This information can be found on the DFSA's

[14] See http://www.ftnet.dk.

[15] See http://www.nationalbanken.dk.

	website. Relevant information can also be found at the website of DNB.[15]
Assessment	Compliant.
Comments	A specific provision in the FBA, or separate legislation, explicitly establishing the DFSA would provide a clearer explicit definition of its autonomy and accountability, hence making the organization of financial supervision in Denmark more transparent. In this context, however, it should be mentioned that it is common tradition in Denmark to establish a public authority by government decision rather than by statute.
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	There is no visible evidence of any government or industry interference in the work of the DFSA. Assigning competence to a separate authority, such as the FBC, is sufficient under Danish constitutional arrangements to ensure that a Minister can no longer exercise powers in that area. The DFSA has, in practice, adequate autonomy in deploying its banking supervision resources. The DFSA is an agency for which the minister of economic and business affairs is accountable to parliament, but much of its banking supervision activities are under the jurisdiction of the FBC. The FBC takes decisions on: • supervisory matters of a principle nature; and • supervisory matters with far reaching, significant consequences for financial undertakings or financial holding companies. In addition to these decision making functions, the FBC advises the DFSA: • in connection with regulations issued by the DFSA; • in supervisory matters regarding business principles and good practices with far reaching, significant consequences for financial undertakings or financial holding companies; and • assists the DFSA in its information activities. The DFSA reports to the MoEBA, which precludes active and ongoing intervention by the legislature or other governmental bodies. In all specific supervisory cases—i.e. regarding noncompliance—the DFSA refers to either the FBC or to the Danish Securities Council (DSC). However, the DFSA is an institution under the aegis of the minister of economic and business affairs, and the minister is the director general's ultimate superior. This could potentially lead to restrictions on the independence of the DFSA, because it could not be precluded that the minister of economics and business affairs might overrule decisions made by the DFSA on advice by the FBC, for example with regard to the content of executive orders. The MoEBA could instruct or influence the work of the DFSA by presenting new legislation, with which the DFSA might not agree. The minister may give instructions to the DFSA on other matters, such as asking the DFSA to examine specific areas or entities. In practice, the minister confines himself to asking questions on specific cases and approving the annual performance contract, which lays down the goals for supervisory activities in the following year. The contract states that the DFSA should act independently within the limits of the contract and legislation, but this contract is not legally binding. In some other matters, such as crisis management, the DFSA must have advance guidance from the MoEBA. In addition, the minister of economics and business affairs has the power to ask for reports on specific supervisory matters from the DFSA, give his own opinion on supervisory issues, and may question the DFSA in private or in public. The DFSA's banking supervision staff enjoys considerable credibility based on its professionalism, experience, and integrity. This is evident through, e.g., the high qualification and experience of the staff. The DFSA has also issued a set of ethical rules and guidelines applying to its employees. The DFSA has no budgetary independence, because its expenses are included in the central

	government's budget and approved by the Danish Parliament in the annual Finance Act. However, the DFSA is able to build up reserves so as to be able to react to unexpected developments in the future. The allocation of funds between regulatory and supervisory activities in the budget is nonbinding. Thus, by increasing regulatory activities required from the DFSA, the minister may in practice reduce funds for supervisory activities. The costs of the DFSA are not paid by the tax payer, but are recovered from the undertakings under its supervision (FBA Section 360). The salary policy of the DFSA is based on the level of remuneration and the terms of service for staff of the Danish government service in general and reflects the labor market situation only indirectly. The DFSA has to compete, e.g., with banks, for highly qualified staff and its ability to hire outside experts is limited by the budgetary process. However, there is some flexibility in the salary structure. Nevertheless, this could cause problems for any the expansion of its supervisory responsibilities, e.g., for an increase in the number of on-site inspections necessary for the implementation of the new Basel Capital Accord and EU Directives. The DFSA's travel budget for on-site work permits appropriate supervision on a (global) consolidated basis. The high level of qualification of the staff is preserved by extensive training measures, but continued work is needed to maintain this level. The total number of professionals employed with the DFSA is 130, of which 46 are solely involved in banking supervision (in 2005, the total number of full-time staff was 181). The DFSA has a permanent appropriation for preparation for Basel II. In 2004, the turnover level was 7 percent for the DFSA as a whole. However, in the light of the expected increase in on-site visits, the implementation of Basel II, and the new anti money laundering law, the current staff resources may be stretched.
Assessment	Largely compliant.
Comments	Discussions with the DFSA suggest there is no visible evidence of any government or industry interference in the work of the DFSA. However, the DFSA is an institution for which the minister of economic and business affairs has responsibility. This could potentially limit its independence, because it cannot be excluded that the MoEBA might overrule decisions made by the DFSA on the advice of the FBC with regard to the issuance of executive orders. The MoEBA could instruct or influence the work of the DFSA by adopting new legislation contrary to the advice of the DFSA. Specific statutory provision for the establishment of the DFSA and its independence would clarify its position and make the organization of financial supervision in Denmark more transparent. The DFSA has no formal budgetary independence, because its expenses are included in the central government's budget. For the present level of responsibility staffing levels seem to be adequate, but resources may have to increase and will have to be re-prioritized to cope with additional on-site inspections likely to be needed, e.g., for the implementation of Basel II and the new anti-money laundering law.
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	Under Sections 7 and 14 of the FBA, the DFSA is responsible for granting, and under Sections 223–225 of the FBA for withdrawing, banking licenses. Pursuant to the FBA, foreign banks and foreign entities of Danish banks are authorized to open branch offices and subsidiaries only after prior notification to the DFSA. In order to organize and exercise supervision, the DFSA has the right, under the FBA to issue executive orders and to provide recommendations and explanations. In addition, the DFSA can issue circular letters and guidelines, but these do not have the same legal status as laws or executive orders.

	Section 347 of the FBA gives the DFSA the power to demand information from credit institutions and shareholders who have qualifying holdings and companies belonging to a consolidated group in the form and frequency it deems necessary. The legislation and prudential regulation for banks does not automatically cover the Faeroe Islands and Greenland. The legislation and regulation is entered into force separately in these parts of the country approximately one year after the changes enter into force in Denmark.
Assessment	Compliant.
Comments	
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.
Description	Section 344 of the FBA enables the supervisor to address compliance with laws and the safety and soundness of the banks under its supervision. The FBA permits the supervisor to apply qualitative judgment in forming his opinion. According to Section 347 of the FBA, the supervisor has unfettered access to banks' files in order to review compliance with internal rules and limits as well as external laws and regulations. Based on this information, the DFSA is free to assess the evidence and to formulate its judgment with regard to compliance of the supervised institutions with law and regulations and reach its own decisions whether and how to make use of its sanction powers under the FBA. Section 350/1 of the FBA enables the DFSA to take and/or requires a bank to take supervisory measures. Furthermore, the DFSA can revoke a bank's license if it violates prudential rules established by, or on the basis of, the FBA and remedial measures have not been taken within the specified time limit. Additional regulation for withdrawing a license is outlined in Sections 224/1 and 225/1, e.g., if a bank has not raised the capital required prior to the time limit set by the DFSA.
Assessment	Compliant.
Comments	The DFSA has a range of remedial measures and sanctions at its disposal. Further assessment and discussion is included under CP 22.
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	The legal protection for supervisors is currently not addressed in the FBA. However, the Act on Liability Claims provides legal protection to all employees of all organizations for action taken in good faith. Although there is no formal DFSA indemnification policy protecting employees against any costs of defending their actions while discharging their duties, an employee will only be held personally responsible for an activity performed for the DFSA, if the employee acts with gross negligence. In practice, personal liability for civil servants is close to nonexistent, except in cases of willful misconduct.
Assessment	Compliant.
Comments	
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	The DFSA is an integrated supervisory agency. Therefore, there is no need for special agreements on how to share information between supervisors of different sectors. There is regular cooperation with the DNB on issues like financial stability and payment systems. A general MoU guiding the general cooperation under the responsibility of the Governor of DNB and the Director General of the DFSA regarding financial surveillance is in place and it establishes self-contained agreements concerning cooperation in relevant areas, including statistics. The DFSA may request information and documents from foreign banks and financial market supervisory authorities and has the authority to undertake direct inspections of foreign

	establishments of banks. As a member of the EU, Denmark takes part in the EU system of cooperation and information sharing, including several agreements with countries outside the EU. Several MoUs on information sharing have been agreed, with the United Kingdom, France, Germany, Ireland, Holland, Hong Kong, the Scandinavian countries, Estonia, and Lithuania. The FBA stipulates the extent to which the DFSA can forward confidential information to others and how these others are to treat the information in matters of confidence. Section 354/9 require that information can only be provided on the basis of international cooperation agreements and that the recipients of said information are, at a minimum, subject to a statutory duty of confidentiality. There exists no specific direct requirement for DFSA to take reasonable steps to ensure that any confidential information released to another supervisor will be used only for supervisory purposes. The DFSA can deny any demand for confidential information, except in the cases mentioned in Section 354/5 (which deals with matters being considered by the Company Appeals Board). If the DFSA has to forward any confidential information as a result of a demand mentioned in Section 354/5, the information will still have to be held confidential by the receiver. This is stipulated in Section 354/6.
Assessment	Compliant.
Comments	
Principle 2.	**Permissible Activities** The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
Description	The term bank is clearly defined. Under Section 7/1 of the FBA a bank is a company whose principal and permanent activity is to receive cash deposits and to grant loans for its own account and provide other financing, except on the basis of issuing mortgage-credit bonds. Banks have, pursuant to the FBA Section 7/5 and 6, the exclusive right as well as an obligation to use the words "bank," "sparekasse," or "andelskasse" in their name. The FBA Annex 1 and Sections 24–26 list in detail the transactions and actions that are permissible for banks including those that are directly ancillary or supplemental to its principal activity. In addition, banks may be licensed as securities dealers to carry out the activities mentioned in Annex 4, Schedules 1 and 3. Pursuant to Section 7/5 of the FBA, only institutions that have obtained a license from the DFSA are allowed to use the term "bank," "sparekasse," or "andelskasse," alone or in combination with other words, in the company name, designation of the business purpose, or advertising. Other undertakings, except for banks established by law, may not use names or expressions for their activities that create the impression that they are a bank. The term mortgage-credit institution is defined in Section 8/1 of the FBA: undertakings which grant loans against registered mortgages in real property on the basis of issuing mortgage-credit bonds shall be licensed as mortgage-credit institutions. Mortgage credit institutions have exclusive right to use words such as "realkreditinstitut," "realkreditaktieselskab," "kreditforening," or "realkreditfond" in their names. Mortgage-credit institutions may only carry out activities as mentioned in Annex 3 and activities under Sections 24–26. In addition, mortgage-credit institutions may be licensed as securities dealers to carry out the activities mentioned in Annex 4, Schedule 1, regarding mortgage-credit bonds and instruments derived from these. According to Section 7/3 of the FBA, the following undertakings have the exclusive right to receive from the public deposits or other funds to be repaid:

	• banks; • the state; • Danmarks Nationalbank; • foreign credit institutions; • issuers of electronic money which are supervised by the DFSA pursuant to Part 19 of the FBA; • savings undertakings which are supervised according to Part 20 of the Act; and • mortgage-credit institutions, DSF (Danmarks Skibskreditfond), and KommuneKredit may, according to Section 7/3, receive other funds to be repaid. Undertakings which do not receive deposits from the public may receive other funds to be repaid provided this activity or lending activities are not a significant part of the normal activities of the undertaking.
Assessment	Compliant.
Comments	
Principle 3.	**Licensing Criteria** The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Description	Prior to engaging in banking activities in Denmark, each institution is obliged to obtain a license from the DFSA (Sections 7 and 14 of the FBA), which is the sole authority for granting banking licenses. A Danish banking license is not limited to specialized business fields such as commercial, investment, private banking. The regulations governing the acquisition of an existing bank basically parallel those governing the initial establishment. Before the DFSA grants a banking license, it must ensure that the undertaking in question meets certain criteria (Section 14/1 and 2 of the FBA): e.g., the undertaking uses the term "bank," "sparekasse," or "andelskasse" in its name (Section 7/5); has a share capital of no less than €8 million (Section 7/1 of the FBA); is organized as a limited company (section 12); and intangible assets are not used to pay for shares in banks and mortgage-credit institutions (Section 13). According to the explanatory note to Section 14/1 of the FBA, the DFSA will usually require, e.g., a description of the basis for business activities. The DFSA's licensing guidance and practice are consistent with those of the EU's Banking Directive concerning licensing and supervision of credit institutions in general. In its implementation, every bank is required to manage its business in accordance with sound administrative principles and to put in place and maintain internal controls, reporting arrangements, and procedures to ensure that the business is well managed. Pursuant to Section 224/1 (no 2) of the FBA, the DFSA can withdraw a license if a bank does not adhere to the criteria applied when issuing the license. The DFSA may discover or ascertain such deficiencies during its ongoing supervision which, according to Section 346/1 of the FBA, is based on reviews of regular reports and inspections of individual undertakings. The initial capital requirement for a bank or a mortgage-credit institution is €8 million, (FBA Sections 7(8) and 14(1)). According to Section 124/1 (no 2) of the FBA, the minimum capital requirement for a bank already in operation is, however, €5 million. During the licensing process, the DFSA has to ensure that the capital is actually there on the day the license is given. The DFSA does not trace back the source of the initial capital, but it has, nevertheless, an obligation to inform the Public Prosecutor for Serious Economic Crime if it learns of

	circumstances that are presumed to be associated with money laundering or financing of terrorism (see detailed AML/CFT assessment). The DFSA also establishes the financial soundness of the prospective owners and their ability to support the business. The criteria for issuing licenses are consistent with those applied in ongoing supervision. Section 14/1 and 3 of the FBA gives the DFSA the right to reject applications if the criteria are not fulfilled or if the information provided is inadequate. The DFSA has published a Guideline for License Applications for Banks. The FBA enables the DFSA to reject the proposed legal and managerial structures of the bank if it could hinder effective supervision. Section 14/1 of the FBA requires the DFSA to determine, e.g., the suitability of major shareholders, transparency of ownership structure, and source of initial capital. Pursuant to Section 14/1 no. 3, of the FBA, the DFSA shall only grant a license when the owners of qualifying interests will not oppose appropriate and reasonable management of the bank or mortgage-credit institution. The DFSA, thus, conducts a fit and proper evaluation on owners of qualifying interests. According to the DFSA's "Guidelines on requirements in financial legislation for fitness and propriety of members of boards of management and boards of directors and requirements for approval of owners of qualifying interests," a fit and proper evaluation is prompted when the DFSA has reason to believe, e.g., that the shareholder will counteract appropriate operation of the bank or mortgage-credit institution, cf. Section 61/1 of the Act. Section 14/1 no. 2 in conjunction with Section 64 of the FBA and the above mentioned guideline lay down the evaluation criteria for the DFSA regarding the fitness and propriety (education, experience, professional qualification, and trustworthiness) of the proposed board of directors and board of management. Directors and managers of the bank must be competent and fit for the specific business of the new bank, i.e., their personal integrity and professional skill as well as their experience, must meet the demands of their new task. All license applications must include a curriculum vitae and a statement if the person in question has been held liable for violation of the Criminal Code, financial legislation, etc. If a person in question is rejected, this decision is final also for future applications. In addition, pursuant to FBA Section 14(1), no. 3, the DFSA shall only grant a license when the owners of qualifying interests are believed not to oppose appropriate and reasonable management of the bank or mortgage-credit institution. The DFSA Guidelines lay down the details on this matter. The qualified shareholders and the banks have a legal duty to report the relevant shareholdings and their changes to the DFSA. The DFSA is entitled to enforce the "fit and proper" requirement by suspending the voting rights of noncomplying shareholders up to revoking the banking license in severe cases. Apart from this qualitative requirement the banking legislation applies no quantitative limitation on ownership in banks. An application for a license to operate as a bank shall, pursuant to Section 14/2, contain all information necessary for the assessment by the DFSA of whether the requirements in Section 14/1 have been fulfilled, including information on the size of the qualifying interests and the organization of the undertaking. The application shall also contain information about the nature of the business intended. According to the explanatory notes to Section 14 of the FBA, the DFSA will demand and examine information on, *inter alia*, the applicant's articles of association, a description of the basis for business activities, the standing orders for the board of directors, the instruction from the board of directors to the board of management, and written procedures for significant areas of business. The bank to be licensed has to set up an organization that is able to meet the demands of the projected business. Section 70 of the FBA stipulates that the board of directors of a bank

	respectively is to prepare written guidelines on the most significant areas of activity of the bank, specifying the division of responsibilities between the board of directors and the board of management. Furthermore, Section 71/1, Nos. 1–3, of the FBA stipulates that banks must have • good administrative and accounting practices; • written procedures for all significant areas of activity; and • full internal control procedures. According to Section 54/1, 2nd clause, of the Companies Act, the Board of Directors is responsible for ensuring proper organization of the business of the company. The Companies Act applies to all banks in this respect. According to FBA Section 14(1), no. 2, members of the board of directors and board of management of the applicant must meet the requirements in FBA Section 64 in order for the DFSA to issue a license. Section 64(1) and the DFSA Guidelines lay down details on this matter. According to the DFSA's "Guidelines for banks pursuant to Section 71/1, Nos. 1–3, of the FBA" (No. 9040 of January 12, 2005) the following overall requirements apply to the procedures: • they must be kept up to date; • they must be easy to read; • they must describe actual circumstances; • they may not leave any doubt as to who is responsible for each individual task; • it must be clear who has completed each individual task; and • they must contain control elements. Similar guidelines are issued for mortgage credit institutions. The need to prepare written procedures will vary from bank to bank. However, most banks will, as a minimum, have to prepare written procedures. According to Section 14/1 and the explanatory notes to Section 14 of the FBA, concerning the documents to accompany the authorization application. This includes pro forma financial statement (budget for a 3-year period), financial information on the principal shareholders, cf. the DFSA's "Internal procedures on approval of qualifying interests" pursuant to Section 61 of the FBA. Thus, the DFSA's assessment involves examination of the financial information on the owners. Pursuant to Section 30/1 of the FBA, a foreign undertaking which has been granted a license to carry out the activities mentioned in Sections 7 (banking activity) and 8 (mortgage-credit activity) in another country within the EU or in a country with which the Community has entered into an agreement for the financial area (EU/EEA), may begin carrying out activities in Denmark through a branch two months after the DFSA has received notification from the supervisory authorities of the home country. This implies at least a statement of "no objection" from the home country supervisor. However, specific prior consent is not required by law rules and regulation. According to Article 12 of Directive 2000/12/EC, there must be prior consultation with the competent authorities of the other member state involved in the authorization of a credit institution. Moreover, these consultation procedures are manifested in the DFSA's "internal procedures on the processing of applications for licensing banks," according to which the DFSA obtains prior consent of the home country supervisor. Under Section 224/1 of the FBA, the DFSA has the authority to revoke a license. In addition, in

	accordance with Danish administrative law, the DFSA can revoke an invalid administrative decision. If the information provided to support the license was knowingly false, the decision will be deemed invalid. The DFSA will then revoke the license. According to the FBA, the DFSA is in the position to punish bank management in the case furnishing wrong information.
Assessment	Largely compliant.
Comments	To a large extent rules and regulations are based on relevant EU directives. The assessment of the beneficial owner suitability of major shareholders, transparency of ownership structure and source of initial capital is only required by law or rules and regulations in a very indirect way. Greater clarification would be desirable. The fit proper test of the DFSA covers only the members of the Board of directors and the Board of managers (often restricted to one or two individuals). An assessment required by the FBA, at least, of the remaining senior management might be useful and facilitate prompt action. In the case of foreign banks establishing a branch or subsidiary, prior consent (or a statement of “no objection”) of the home country supervisor is not required formally by law rules and regulation.
Principle 4.	**Ownership** Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	A direct or indirect holding in a company which represent 10 percent or more of the share capital or votes in the company is deemed to be a qualifying interest (Section 5/3 of the FBA). According to Section 61/1 of the FBA, prior notification and authorization is required for a person to seek to acquire a qualifying holding of 10 percent or more in a bank or mortgage bank or to increase a qualifying holding so that the proportion of the share capital or votes in the bank held by that person exceeds 20 percent, 33 percent, 50 percent or so that the bank would become controlled by that person. Pursuant to the FBA Section 61/2, acquisition or increase of the interest mentioned in Subsection 1 shall only be approved when approval is not contrary to ensuring appropriate operation of the bank. Owners of capital holding an interest of at least 10 percent, and who intend to reduce said interest so that it falls below one of the limits stipulated in Subsection 1, shall notify the DFSA and state the size of the intended future interest (Subsection 6). Prior notification is required for any direct or indirect acquisition or reducing said interest by a bank of a qualifying interest in a foreign financial undertaking as well as of such increases in the qualifying interest which mean that said interest comprises or exceeds a limit of 20 percent, 33 percent, or 50 percent, respectively of the voting rights or share capital of the company, or that the foreign financial undertaking becomes a subsidiary undertaking. Section 61/1 of the FBA gives the DFSA the right to refuse to grant authorization for acquisition or increase of a qualifying holding. The authorization can also be withdrawn in an indirect way, if for example the activities of the shareholder cause a significant risk to the sound and prudent management of the credit institution, by threatening the revocation of the license. Where owners of capital holding and one of the interests mentioned in the FBA Section 61/1 act contrary to appropriate operation of the undertaking or holding company, the DFSA may, pursuant to Section 62/1 of the FBA, order the bank to follow specific guidelines made by the DFSA and withdraw the voting rights associated with the holdings of the relevant owners. The exercise of voting rights by significant shareholders that do not obtain the approval of the DFSA may be suspended. According to Section 61/8 of the FBA, banks shall, no later than February each year, submit information to the DFSA of the names of the owners of capital who own qualifying interests in

	the bank or mortgage-credit institution as well as information on the sizes of said interests.
Assessment	Compliant.
Comments	There is no formal process in place to identify the identities of beneficial owners in the notification process where these differ from the shareholders of record (although in practice this has not proved a difficulty). According to Section 61/8 of the FBA, banks shall, no later than February each year, submit information to the DFSA on the names of the owners of capital who own qualifying interests in the bank or mortgage-credit institution and the sizes of these interests. A clearly defined list of measures or corrective actions for the supervisor should be included in the FBA or an executive order in order to ensure a transparent ownership structure or to disqualify unsuitable persons or entities as shareholders of a bank. The DFSA should be obliged to consult in every case with the home supervisor before granting authorization for the acquisition of a significant participation in bank by a foreign credit institution or by the parent undertaking of a foreign credit institution.
Principle 5.	**Investment Criteria** Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	Generally, the FBA imposes no specific structural conditions or restrictions on banks engaging in securities activities or insurance business. FBA Sections 145, 146, and 147 specify how and within which limits banks and mortgage-credit institutions can place their funds. The DFSA is able to exempt from the specific limits. FBA Section 180 provides that the DFSA can order banks and mortgage-credit institutions to dispose of holdings in other financial undertakings, while Section 182 provides that banks and mortgage-credit institutions cannot, without the approval of the DFSA, have exposures within the same group except for the rules covering exposures with subsidiaries**.** Holdings in other companies held by banks may not, pursuant to Section 146/1 of the FBA, exceed 100 percent of the base capital. Base capital is defined in FBA Section 128 as the reduced core and additional capital, i.e., after the standard deductions. Holdings acquired for funds for performance-related pay shall not be included in the calculation under the first clause. The DFSA may grant exemptions from Subsection (1), of Section 146/4 of the FBA. According to Section 139/5 and 6 of the FBA, the excess of any single investment above 15 percent of liable capital and the sum of these investments above 60 percent of the liable capital would be deducted from liable capital, and this rule applies also on a consolidated basis. In general, banks are required to notify the DFSA in advance of an acquisition or investment. Pursuant to Section 145/3 of the FBA exposures that amount to 10 percent or more of the base capital shall be notified to the DFSA each quarter. According to Section 25 of the FBA banks may, temporarily, carry out other activities to secure or phase out exposures already entered into, or with regard to restructuring enterprises. The DFSA must be informed regarding the latter. In addition, limits exist on: • Banks may not own real property or acquire holdings in property companies amounting to more than 20 percent of the base capital. • A bank may not have a residual risk under leasing agreements the value of which, together with real property and holdings covered by Section 147 of the FBA amounts to more than 25 percent of the base capital. • Special regulation applies to mortgage-credit-institution regarding the placement and liquidity of funds. According to Section 153/1 of the FBA, mortgage-credit institutions shall place funds corresponding to no less than 60 percent of their base capital in

	specified assets. The FBA or respective regulations do not provide formal criteria by which to judge individual proposals. The acquisition of a qualifying holding in a credit institution by another credit institution is governed by the general rules concerning the acquisition of qualifying holdings, where the DFSA requires that the applicant be in a sound financial situation, and that the acquisition will not complicate supervision.
Assessment	Largely compliant.
Comments	The FBA does not require prior approval of investments in non financial companies and consequently there are no criteria by which to judge individual proposals.
Principle 6.	**Capital Adequacy** Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.
Description	The FBA along with the: • EO on Capital Adequacy, and • Guidelines on Solvency Need vested in it under that legislation, apply to all banks operating within Denmark. The principles applicable to banks, together with capital requirements for banks laid down in Part 10 of the FBA. The provisions contain a specification of: • the components and structure of bank capital; • the equity requirements; and • the deductions from required equity. The eligible components of capital are set out in the FBA Section 128. Hybrid core capital under Subsection (1), no. 7, shall be no more than 15 percent of the core capital after the deductions mentioned in Section 131. The additional capital shall not be included with more than 100 percent of the core capital after deductions**.** Holdings in credit institutions or finance institutions shall not be deducted from the base capital when the holdings are acquired temporarily, and the acquisition takes place as part of a reconstruction. Holdings in credit institutions and finance institutions that are included in consolidation shall not be deducted from the base capital. This is also applied to subordinated capital injections in credit institutions and finance institutions covered by the consolidation (options with regard to the EU Banking Directive). Denmark has implemented the European Parliament and Council Directive 2000/12/EC, and Council Directive 93/6/EEC on the Capital Adequacy of Investment Firms and Credit Institutions. The requirements of these directives are broadly consistent with those of the Basel Capital Accord. Section 124 of the FBA stipulates that the paid in share capital of a bank to be established shall be at least €5 million. The FBA Section 124 states, that the base capital (capital) of banks and mortgage-credit institutions shall constitute no less than 8 percent of the risk-weighted items (the solvency requirement). This capital ratio should be maintained at all times. For mortgage-credit institutions, the solvency requirement shall be met for both the individual series of bonds with serial reserve fund and for the institution in general.

	The DFSA has the right to establish a higher rate of capital adequacy (Section 124/4 of the FBA). Under Sections 170/ and 172/2 of the FBA, the capital adequacy ratios are to be calculated on both a consolidated and a solo basis for the banking entities within a banking group. The solvency ratio requirement shall also apply to bank holding companies. The required capital ratio is based on the risk profile of individual banks, in particular credit risk and market risks. Section 142 of the FBA states, that the risk-weighted items according to section 124 of the FBA shall mean items with a credit risk, share price exposure, interest rate risk, currency risk, and commodities risk. Risk-weighted items comprise both on-balance-sheet and off-balance-sheet items. Banks must report their capital adequacy ratio solo and for the consolidated group quarterly. Very small banks with a so-called 'employed' capital of less than DKr 250 million shall only report capital ratios and their components every half year. According to Section 75/3 of the FBA the DFSA has to be informed immediately whenever capital requirements are not met. The FBA Section 225/1 states that if the bank does not meet the capital requirements mentioned and if the bank has not raised the capital required prior to the time limit set by the DFSA, the DFSA shall withdraw the license. Under the FBA, the DFSA has the right to enforce sanctions for violations of the provisions of the FBA on capital adequacy (please refer to CP 22).
Assessment	Compliant.
Comments	In cases where the DFSA determines that the solvency need is inadequate it is authorized to impose an individual solvency requirement upon the bank according to Section 124/4 of the FBA. If the DFSA imposes such a requirement upon a bank, it will usually happen as an outcome of an on-site inspection. The actions that the bank should take in cases where the capital falls below minimum requirements are set out in the FBA. The DFSA has not issued guidelines in this respect, (e.g., defining what response would follow specified failures or setting out an action plan), but guidelines might be helpful.
Principle 7.	**Credit Policies** An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
Description	FBA Sections 70 and 71 (1) state that the Board of Directors of a bank shall prepare written guidelines and procedures on the most significant areas of activity of the bank. The FBA requires the DFSA to issue guidelines to banks and these require that areas of responsibility be clearly defined. The guidelines also indicate how banks should calculate the risks in specific credit exposures and require collateral to be valued prudently. Banks' policies should lay down who has authority to grant credit and limitations on such authority. It should also be indicated which credit activities are reserved to the board of directors itself. The guidelines also require the board of management to report to the board of directors on the extent of the bank's credit risk periodically. Such reports should indicate the total amount of credit exposure, details of the largest exposures, sectoral, product, and geographical breakdowns. Indicators of the quality of the portfolio should also be reported. The board must review its credit policies at least annually. The review must include the extent of any connected lending. The guidelines also require that banks separate authority to grant credit and the control of credit exposures. The Board must ensure that adequate arrangements are in place for the monitoring of credit exposure. Banks must also ensure that written guidelines are prepared for the granting of credit and that these are communicated to all staff involved in the granting and control of credit. During on-site inspections the DFSA evaluates a bank's credit policy, its procedures for granting credit, the organizational structure, duties and responsibilities of those involved, principles for valuing collateral, arrangements for monitoring

	the credit portfolio, and the principles for recognizing the impairment of credits and the making of provisions and writing-off of bad debts. There is no specific requirement that management monitors the total indebtedness of borrowers from the bank. The bank's records must be available to the DFSA, as must the detailed minutes of the discussions and decisions of the board of directors. Relevant staff of the bank must also be available to the DFSA. The DFSA inspectors review all these documents during the course of inspections. The DFSA has authority to order the board to replace management if there are persistent weaknesses in the credit granting and review process.
Assessment	Compliant
Comments	
Principle 8.	**Loan Evaluation and Loan-Loss Provisioning** Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.
Description	The DFSA does not lay down rules for the evaluation of the quality of assets, their classification and provisioning, but it does require boards of directors of banks to set out specific policies for dealing with problem credits. Valuations are to be based on accounting principles for banks, which in turn are based on EU Accounting Directives. With effect from January 2005, these have been based on International Financial Reporting Standards (IFRS), including International Accounting Standard (IAS) no. 39 issued by the International Accounting Standards Board (IASB). These provisions are specified in detail in the EO on Financial Reports for Credit Institutions and Investment Companies made under FBA Section 196. The Guidelines pursuant to FBA Section 71 require boards to set out banks' policies in this regard. Implementation of these policies is vetted during the course of inspections by the DFSA. During inspections, the DFSA reviews the bank's classification system. It also uses its own classification as a means of ensuring that provisioning is adequate and consistent across banks but does not require banks to use this system for its own internal review and control processes. External auditors are also required by the EO to state in their report, which is made available to the DFSA, whether the valuations used by the bank reflect best estimates of the realizable value of the exposures. FBA Section 5(1) defines an exposure as the sum of amounts owed that involve a credit risk for the bank. The EO on large exposures also states that guarantees and other contingent liabilities should be included in the bank's exposures. The guidelines made under FBA Section 71 state that banks must have policies authorizing the writing-off of losses on lending and guarantees. Section 52 of the EO states that banks shall at each balance sheet date recognize any objective evidence of impairment as defined in IAS No. 39. During its inspections the DFSA ensures that these procedures are implemented and that the bank is organized in such a way to facilitate this process. FBA Section 344 empowers the DFSA to order a bank to change the level of provisions to ensure that it meets the requirement to recognize all evidence of impairment. Banks are required to report asset quality and associated provisions on a quarterly basis and annually, including details of the largest accumulated impairment losses as well as the ten largest losses incurred during the year. From end-2005, banks will also be required to report exposures where the objective evidence of weakness is not sufficient to justify raising a provision, but which management considers a weak exposure. Credit policies approved by the board should also cover the assessment of the strength of guarantees and the valuation of collateral, which must be based on market values net of any transaction costs likely to be incurred on realization. Implementation of these requirements is assessed during on-site inspections.
Assessment	Compliant

Comments	The DFSA does not require that loans are classified on the basis of any mechanical rule, such as the number of days servicing payments are in arrears but instead relies on the tests laid out in IAS No. 39. The DFSA does not find that such a mechanical rule would add significant value to the supervision of the banks' asset quality, bearing in mind the tradition of banks being obliged to develop their internal risk classifications. The DFSA finds that the rules for recognition of impairment losses/provisions laid down in the IAS standards and implemented in the Danish regulation give a sufficient measurement of the banks' asset quality. Banks are, however, obliged to report loans on which scheduled payments have not been made. Some banks have released some provisions for weak loans on the grounds that they were not based on objective evidence of impairment (as required under the new accounting standards) but on a more subjective test. Hence the DFSA's request that banks report such loans in future.
Principle 9.	**Large Exposure Limits** Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.
Description	Exposures to single borrowers include exposures to two or more customers that are connected in such a way as to meet the test in the EU Directive (2000/12/EC), namely that if one of them were to experience financial problems, the other(s) would also be likely to encounter payment difficulties. The EO on Large Exposures (Annex 2) lists examples of groups of borrowers that the DFSA considers related and that should be treated as single borrower but makes clear that the list is not exhaustive. All exposures, including off-balance sheet exposures, before deduction of any provision, in excess of 10 percent of base capital must be reported quarterly. These requirements apply at a bank level and on a consolidated basis. Guidelines under FBA Section 71 require banks to have policies regarding the monitoring and control of large exposures approved by the board. Implementation of these policies is assessed during on-site inspections. The EO on Auditing Financial Undertakings requires both internal and external auditors to ensure that exposures in excess of 10 percent of base capital are properly identified and reported to the board and to the DFSA. FBA Section 145(3) provides that exposures may not exceed 25 percent of base capital after deduction of certain defined types of very high quality collateral. Any exposure in excess must be reported immediately. The FBA does, however, permit temporary excesses, but only in special circumstances. The total of all exposures in excess of 10 percent of capital must not exceed 800 percent of base capital. The EO defines in more detail how exposures are to be calculated. Exposures guaranteed by a financial institution are regarded as exposures to the guarantor. The DFSA receives only annual information on the sectoral breakdown of the credit portfolio.
Assessment	Compliant.
Comments	The bank must, pursuant to FBA Section 145 (3), report quarterly its large exposures. Moreover banks are required to report immediately any breach of the large exposure limit. Since the DFSA in most cases does not examine banks annually, it relies on verification of the required reporting by external auditors in the intervals between inspections. The DFSA has found that in some cases this verification is not sufficient for the DFSA to detect credit concentrations.
Principle 10.	**Connected Lending** In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	FBA Section 78 requires that all exposures to a member of the boards of directors or management, undertakings related to them, or their close relations, or employees must be approved by the board of directors. The FBA defines related companies and individuals. The Minister introduced a bill in November 2005 amending FBA Section 78(4) to treat people who live together in the same way as married people and thus included in the category of persons,

	who cannot have an exposure with the bank without the approval of the board of directors. FBA Section 78(2) requires that any such transaction be undertaken in accordance with the bank's usual business terms and conditions. These requirements apply to all transactions, however small. FBA Section 181 deals with transactions with associated companies and detailed rules are set out in the EO on Intra-group Transactions which defines the parties concerned. The EO requires banks to have guidelines approved by the board of directors on such transactions. The FBA Section 78 requires that any transaction with a director or member of the board of management and parties related to them be discussed in their absence. The discussion and the relevant person's absence must be included in the minutes. Such exposures must be reported to the board and discussed at least annually and must be included in the published annual financial statements. External auditors are also required to review intra-group transactions in accordance with the EO on Intra-group Transactions. The DFSA examines such exposures during on-site inspections. Banks are required to obtain the prior approval of the DFSA for all intra-group exposures. In the absence of this requirement, intra-group exposures could, according to the Credit Institutions Directive, and without prior approval from the DFSA, amount to 20 percent of base capital and carry a risk-weight of 20 percent. According to the Danish rule, banks will normally be allowed intra group exposures up to 25 percent of the minimum solvency requirement in addition to any surplus capital. Such exposures are, however, weighted at 50 percent. The Danish rule has been established to avoid giving incentives to form group structures to save capital. The consequence, however, is the fact that higher intra-group exposures are normally allowed for banks that have capital in excess of the DFSA's requirements. Intra-group exposures may not exceed 100 percent of base capital.
Assessment	Largely compliant
Comments	The DFSA has no power to deem that a connection exists in cases others than those specified in the law. All exposures to connected parties must be discussed and approved by the board. Where a bank is part of a group of companies, then the limits on intra-group transactions can be high, as much as 100 percent of base capital, in order to permit the group to function effectively as a single business unit. The DFSA should consider the need for a power to use its discretion to make judgments about the existence of connection between a bank and other parties or to require such exposures to be collateralized.
Principle 11.	**Country Risk** Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
Description	Significant country risk is only relevant for the major banks and these have procedures for monitoring and controlling country and transfer risk. In such cases the guidelines under FBA Section 71 require the board of directors to approve credit policies, including on country risk. These are examined during on-site inspection of the DFSA. It is up to individual banks to adopt policies for assessing the quality of country exposure and for adopting appropriate provisioning policies. These are reviewed by the external auditor and assessed by the DFSA during on-site inspections.
Assessment	Compliant.
Comments	There is no routine reporting requirement on a country by country basis. But the DFSA reviews exposures during on-site inspections and has the right to require ad hoc reporting as necessary.
Principle 12.	**Market Risks** Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.
Description	Section 3 of the guidelines issued under FBA Section 71 requires that banks have systems, approved by the board of directors, to measure, monitor, and control market risks. These include organizational aspects, authorities and procedures, internal controls, reporting systems

	and computer systems use and control. These are reviewed by the DFSA and their implementation examined during on-site inspections. Banks are required to have policies, approved by the board, which set out the desired risk profile of the bank and which set out limits that will apply to positions taken and counterparty limits for example. Policies should also include detailed methods of calculating exposures and positions subject to limits. Overall limits in various markets, including foreign exchange, interest rate risk, and derivatives. Trading activity is defined broadly and includes all business in marketable securities. All trading activity is subject to the limitations imposed by the EU directive on Capital Adequacy of Investment Firms and Credit Institutions and conforms with requirements in the Basel Capital Accord and the Market Risk Amendment. FBA Section 142 empowers the DFSA to establish capital charges on market risk and these are detailed in the EO on Capital Adequacy Part 3 and Annex 2. The DFSA also has powers in FBA Section 124 (4) to impose higher minimum solvency requirements on specific banks that might be regarded as carrying a higher level of risk. During on-site examinations, the DFSA verifies that banks have the necessary information systems, risk management systems, and internal controls to ensure that all transactions are captured on a timely basis. It verifies that limits are adhered to and that positions are correctly valued. Those banks that have had authorization to use internal models—so far only three—are required to perform scenario analysis and stress testing techniques. Typically, models are approved for periods of one year only and are then the assumptions are tested and their suitability reviewed before any subsequent approval. While the DFSA experiences the difficulties many supervisory authorities have in hiring and retaining skilled personnel in this area, so far they have been able to supervise the few banks that have been active takers of market risks. The DFSA have established a Credit and Market Risk Division responsible for supervising the major banks, which also provide assistance regarding the supervision of smaller banks and other financial entities when required. The internal inspection manual covers this area in depth. On-site inspections review the reports made to senior managements and boards to ensure that the nature and extent of the risks are properly understood, discussed by the boards, and appropriately minuted.
Assessment	Compliant.
Comments	Resources available to the DFSA in this area are limited. At this stage the number of banks and other institutions undertaking very sophisticated market risk trading is reportedly limited. However, much of the Nordea Group's trading activities is undertaken in Copenhagen. Under its proposed re-organization plan, this activity will become the responsibility of the Swedish supervisory authority.
Principle 13.	**Other Risks** Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.
Description	FBA Section 70 requires banks to have written policies on all significant areas of business. The guidelines under FBA Section 71 specify what these policy documents should cover, including the overall exposure to interest rate risk, both within the trading book and in other activities of the bank, also aspects of operational risk. The policies should also cover the use of derivative instruments to hedge positions in foreign exchange and interest rate exposure. Where the bank is one of a group of companies these policies should provide for an overall management of the group's risks. FBA Section 152 requires banks to observe a stock liquidity requirement so that 15 percent of liabilities maturing within one month, and 10 percent of all liabilities, are covered by holdings of specified liquid assets. Observance of these ratios is reported at the end of each quarter. Mortgage banks are subject to very tight liquidity restrictions according to the 'balance'

	principle, on which they report quarterly to the DFSA. Foreign exchange liquidity management practices are assessed during on-site inspections and subject to periodic stress-testing. The DFSA has not issued minimum requirements in respect of other risks but requires banks to establish their own risk parameters. During on-site inspections it is ensured that they are observed. The guidelines issued under FBA Section 71 require banks to ensure that all relevant staff are aware of the aspects of the bank's policies that affect them. Delegations of authority must be clearly expressed and signed by the individual delegating his authority. IFRS will require banks to include in their published accounts a statement of the bank's risk appetite and use made of it. The DFSA has powers to impose additional capital requirements if they believe that the overall risk is not adequately addressed by the existing minimum requirement. The extent of risk reporting is covered by the EO on Financial Reports for Credit Institutions, which is based on IFRS.
Assessment	Largely compliant.
Comments	Policies are required to cover internal audit, procedures to counter fraud, business recovery plans, and other elements of operational risk. Policies in respect of liquidity are required of banks, but there is no routine requirement for the monitoring and reporting to the DFSA of changes in net funding requirements, stress testing, and contingency planning for possible liquidity crises under various scenarios. However, the DFSA did in historic periods with liquidity strains require vulnerable banks to establish and report on more specific requirements. For instance, the DFSA in the beginning of the 1990s required major and selected banks to report weekly or monthly liquidity tables showing worst case scenarios.
Principle 14.	**Internal Control and Audit** Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.
Description	The Companies Act, Section 54, states that the board of directors and the board of management are responsible for the management of a company. In addition, FBA Section 65 states that the board of directors must lay down detailed procedures for the performance of its duties. When a new member of the board of directors or the board of management is appointed, the new member is obliged to establish that he or she is 'fit and proper' for the position and this is evaluated by the DFSA. During on-site inspections the DFSA will verify the quality of the board of directors and the board of management. FBA Section 70 also requires boards of directors to set out the respective responsibilities of the board and the board of management. FBA Section 70 and the guidelines under FBA Section 71 require banks to have detailed policies for all significant areas of business and these should include the necessary internal controls. During on-site inspections the DFSA will assess, with the help of the board's minutes, the effectiveness of the board of directors and the board of management. FBA Section 71 requires banks to have complete internal control procedures. Boards of directors are responsible for ensuring that the internal controls work properly. FBA Section 64 sets out minimum standards designed to ensure that directors are fit and proper. FBA Section 64 (2) 4 states that a person cannot occupy a board position if there is reason to presume that he cannot fulfill the responsibility of the position adequately. The DFSA has the power (FBA Section 351) to remove a member of the board of management and, during on-site inspections, the DFSA will assess the quality and capacity of members of both boards. The EO on Auditing Financial Undertakings and Financial Groups lays down the

	requirements for internal and external audit of banks. All banks, except for very small institutions, are required to have a professionally qualified internal auditor reporting directly to the board of directors. The EO lays down requirements to ensure that the internal auditor can function independently of the management of the banks and has adequate resources and powers. The internal auditor's reports must be made available to the DFSA, whose inspectors will meet with him during on-site inspections.
Assessment	Largely compliant.
Comments	The DFSA has no specific powers to require the removal of a member of the board of directors, although it may withdraw the license if the board does not fulfill its functions adequately. There is no explicit 'fit and proper' requirement for respective of members of the senior management other than the members of the board of management (often limited to the chief executive and his deputy), nor of the internal auditor and others who are responsible for the internal controls and risk management of the bank. Under the bicameral Danish system of corporate governance, the management is excluded from membership of the board, there is thus less need for an audit committee and internal auditors report to the board as a whole. Although the DFSA evaluates the effectiveness of the board as a whole, the performance of individual members is not assessed by the board nor by the DFSA, nor does the DFSA have specific powers to require changes in the composition of the board, short of threatening to withdraw the license. A broader range of explicitly graduated measures could be considered. Guideline 9680 does not define clearly enough what Finanstilsynet requires in the area of internal control. As the guideline does not expand on requirements from section 71 FBA, the subsequent control procedure may not cover all relevant issues. The importance of the function requires an executive order.
Principle 15.	**Money Laundering** Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	FBA Section 43 requires that banks operate in accordance with honest business practices. These are expanded on in the EO on Good Business Practice for Financial Undertakings. The DFSA has powers to require compliance with these practices. The Act on Measures to Prevent AMLCFT applies to all banks and implements the 2001 EU directive. The Act requires banks to have appropriate internal controls and training programs for staff. It also requires banks to have customer identification systems and means for identifying parties to transactions who are not customers. The Act also requires banks to have procedures in place to recognize suspicious and unusual transactions. Guidelines issued by the Bankers Association (Finansrådet), but not required by the current law, establishes a system of responsibilities for detecting, investigating, and reporting suspicious transactions to the Public Prosecutor for Serious Economic Crimes. Steps should be taken to suspend the transaction meanwhile if possible. The DFSA's internal inspection manual requires inspectors to cover these areas during on-site inspections. Banks are required by FBA Section 75 to report to the DFSA transactions that are of material significance to the continued operation of the bank. The Money Laundering Act states that bank employees will not be liable for breach of the normal confidentiality rules if they report suspicious transactions. The DFSA verifies that these requirements are observed during its on-site inspections. The FBA Section 354 empowers the DFSA to pass information to other supervisory authorities, Danmarks Nationalbank, and judicial authorities and no legal problems have been experienced so far in sharing information. There is no explicit requirement that banks have a statement on

	ethics, but banks and their directors and employees are bound by the EO referred to above.
Assessment	Largely compliant
Comments	A new law was recently passed, which gives a statutory basis to some areas covered by the Finansrådet's guidelines, for instance the reporting hierarchy. It also enacts the 2003 revisions to the FATF recommendations. It should also be noted that for many small banks, on-site inspections, including of the provisions in the AML legislation, take place relatively infrequently.
Principle 16.	**On-Site and Off-Site Supervision** An effective banking supervisory system should consist of some form of both on-site and off-site supervision.
Description	The FBA Section 344 (9) gives the DFSA responsibility to supervise banks. It authorizes the DFSA to obtain information and obligates banks to provide it, to enter the premises of banks, and to carry out examinations to ensure compliance with the provisions of the Act. The Act requires banks to furnish periodic reports of their condition and other matters. The DFSA appoints in respect of each bank an 'accountable officer' (AO), who is responsible to the Director-General of the DFSA for the supervision of the bank. In accordance with the DFSA's schedule for on-site inspections, the DFSA will inspect the bank and require the bank to undertake any remedial action detected during the inspections. The AO is also responsible for ensuring that the bank complies with these requirements within the timetable specified. On-site inspections are carried out by teams of at least two persons. The DFSA is organized partly on a functional basis, so that inspections carried out by the Banking Division can be assisted by staff from the Credit and Markets Risk Division (responsible for the supervision of the larger and more complex banks), where there is a need for assistance in the technical aspects of market risk supervision or from the Economic, Statistics and IT Supervision Division where there is a need for assessing IT systems, or from the Mortgage Credit Division for expertise on real estate valuation. The resulting report is sent to the bank. In addition to requiring any remedial action, it will focus on the bank's risk profile and it will compare it with its peers. The report is annexed to an internal report, in which the AO assesses the bank's risk profile, risk management, and accord the bank a rating. In conjunction with ratings prepared during the off-site process (described below), this influences the frequency of inspections and other supervisory actions. Inspections also verify the accuracy and reliability of off-site reporting. Generally, inspections are full scope and cover the full range of risks and follow the procedures in the DFSA's comprehensive inspection manual. In the case of larger banks, however, a supervisory program is designed, which covers a four year period, and examinations take place at least once a year, which concentrate in depth on specific aspects deemed to be of high priority, but ensuring that over the four year cycle all significant risks are covered. Smaller banks are generally inspected once every four years, unless the ratings suggest a shorter cycle. Very small and low risk institutions are normally visited only once in seven years. Foreign banks are also inspected, often in conjunction with home supervisors. Off-site supervision is based on quarterly and annual statistical reports, which are designed to be based as closely as possible on the banks' financial statements, now in turn based on IFRS, especially on IAS No. 39. The reports are examined to detect validation errors and compared in order to identify outliers in respect of performance against a series of key ratios and growth rates. Summary statistics derived from these returns are published on the DFSA's web site, broken down by four main groups of banks to enable banks to compare their own position with that of their peers. The AO is informed of the performance of the banks for which he is responsible and may contact the bank to clarify any problem areas. In some cases the officer may ask for a written explanation. In particular, banks with a comparatively rapid rate of growth

	of credit are asked for an explanation. Similarly those with the highest levels of interest rate and share price risk are asked to explain. Each bank is rated on its annual performance (on a scale of 1–9, 1–3 being vulnerable and 4 being borderline) and subjected to certain stress tests. Ratings are also given on this score. The AO then compares his own rating with those derived from off-site reporting. On the basis of all this information (as well as reports from auditors and other market information), the annual program of inspections is established to ensure that high risk institutions are covered in the near future. The process is updated in the middle of the year and consequential changes made to ensure high risk institutions receive priority. An additional source of information is provided by external auditors, who are obliged to furnish a 'management letter' or 'long form report' which, in addition to drawing management's attention to matters arising from the audit of financial statements, also deals with certain specified issues laid down by the DFSA. The result is an important input to the supervisory process. Reports of internal auditors are also used in this way. In addition, on-site inspection teams will meet with both internal and external auditors during the course of an inspection.
Assessment	Compliant.
Comments	The on-site and off-site work are well integrated, helped by the fact that the DFSA is a relatively small agency. The work of internal and external auditors make a valuable contribution although the main source of verification is by DFSA inspections. While the DFSA believes that it has adequate resources to assess the risks, visits to institutions deemed to be low risk are relatively infrequent. Most banks are only inspected once in four years and very small institutions even less frequently. Inspection teams are also modest in size. It is likely that this will be addressed in the government's response to the recent criticisms by the National Audit Office, in part by increasing resources and in part by moving further in the direction of utilizing resources more in proportion to the risks.
Principle 17.	**Bank Management Contact** Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	The DFSA have a formal meeting annually with the largest five banking groups, normally just after the annual financial statements are issued, to cover strategic issues and other high level concerns. Supervisors meet separately with middle management of the major banks several times during the year. For other banks, meetings are held with the board of directors and with the management at the time of on-site inspections, which, if the bank is regarded as vulnerable may be quite frequent. Vulnerable banks, with a rating of 3 or lower, are inspected yearly. Ad hoc meetings may be held at other times when required or at the request of the bank. The AO will seek to ensure, from written reports and on-site inspections that the AO retains, an understanding of the business of the bank and its performance. Banks are required to notify the DFSA under FBA Section 75 of any matters that are of material significance to the continued operation of the bank. This obligation attaches to individual members of the board and the management board as well as to the bank as an institution. If any director or management board member believes that the bank no longer complies with its legal obligations under the FBA, he/she must immediately inform the DFSA. Similarly, if any board member ceases to be 'fit and proper' for his position, the DFSA must be informed. The DFSA assesses the quality of the management at the time of on-site inspections but also as part of the annual rating process on the basis of off-site supervision, including assessment of comments by the auditors.
Assessment	Largely compliant.
Comments	Regular meetings with management at all levels only occur in respect of the five largest banking groups and with low rated banks, which are inspected annually. The DFSA meets the management of other banks at the time of the on-site inspections, which may be infrequent, unless either side has requested meeting to discuss a specific issue. Planned staff expansion may mean that meetings with low risk banks will take place more frequently in future.

Principle 18.	**Off-Site Supervision** Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	The DFSA has comprehensive powers under FBA Section 347 to obtain whatever information it needs from licensed institutions, including from branches of foreign banks. In addition, the DFSA can gain access to bank premises merely on proof of identity. Using these powers, the DFSA requires banks to complete a set of quarterly and annual returns on a solo and on a consolidated basis. The DFSA also has the power under the FBA Section 198 to set out the accounting principles under which banks should maintain records and from which information furnished to the DFSA and published in financial statements is based. As from 2005, these accounting principles comply with IFRS and the accounting regulations of the EU. The DFSA specifies time limits for the furnishing of information and has the power to fine banks, which fail to meet the deadlines. Inaccurate reporting can also lead to fines under FBA Section 374. Information required includes balance sheet and income statements. It also includes details of asset quality and provisioning, details of specific large exposures, off-balance sheet items, etc. The DFSA has a system of analyzing reports from banks. The information is arranged by groups of institution that have similar characteristics. Ratios and indicators are compiled as part of an early warning system. Outliers are identified and supervisors take action where concerns and issues are identified. The information is also used for stress testing purposes and as an input into annual rating processes. Although information is not normally collected more frequently than once a quarter, where a bank is regarded as vulnerable, more frequent information, e.g. on liquidity, is collected, sometimes as often as on a daily basis. The assessment and rating is used to establish priorities for inspections and as preparation for such inspections. The DFSA also receives annual 'long form' reports from external auditors and similar reports from internal audit departments of the bank. In the interval between inspections these reports provide some assurance on the quality of data derived from data reported by the banks.
Assessment	Compliant.
Comments	
Principle 19.	**Validation of Supervisory Information** Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
Description	Supervisory information is normally validated by the Economics, Statistics, and IT Supervision Division, which performs statistical tests to detect errors. More fundamental accuracy is ensured during the process of on-site inspections. The DFSA has unfettered right of access to all information and personnel for this purpose. Although there is no formal program of examination of supervisory returns by the auditor, the external auditor does play a role in ensuring the accuracy of the data. For example, the solvency ratio is required to be included in the bank's published financial statements and must therefore be audited. During on-site inspections, DFSA inspectors meet with both internal and external auditors. Both also have to furnish reports to the bank’s management of their activities during the year. These reports are copied to the DFSA and help ensure the accuracy of reported information and identify possible areas of weakness. The DFSA has the power (FBA Section 199) to dismiss an external auditor. The DFSA also has the power under FBA Section 199 to appoint a second auditor where it has concerns over the reliability of the existing auditor's work. FBA Section 199 also gives the DFSA the power to commission an extraordinary audit at the bank's expense. This has been used on occasion, where there were doubts on the adequacy of loan-loss provisions. Where an external or internal auditor resigns, both the auditor and the bank are required to provide a written explanation for the auditor's departure.
Assessment	Largely compliant.

Comments	On-site inspections may be infrequent, and during the interval between inspections the DFSA has to rely on the external auditor to ensure that information provided is accurate. Although some of the information provided is audited, and the auditor has to make a report to the DFSA, there is no program of annual meetings with auditors to discuss the results of the audit, although the DFSA frequently corresponds with auditors. There are some meetings with auditors of financial institutions to discuss items of mutual interest, but these are held by DFSA staff responsible for accounting matters and supervisors of specific institutions are not normally involved.
Principle 20.	**Consolidated Supervision** An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	The DFSA has the authority to conduct consolidated supervision of banking groups, including groups where the parent is a holding company. In practice, most such groups are headed by a bank. This process is facilitated by the fact that the DFSA supervises all financial institutions and the process can be coordinated relatively easily. There are constraints in FBA Sections 25 and 26, which ensure that banks do not have an active management interest in non-financial business. FBA Section 170-2 ensures that prudential requirements apply to the whole group as well as to individual licensed institutions. Where unsupervised entities are involved, parent institutions are responsible for ensuring that the DFSA's requirements are met. This also applies to contractual arrangements with other companies, for instance where activities are outsourced. The DFSA has signed MoUs and made other arrangements to ensure that it is fully informed about subsidiaries and affiliates outside its jurisdiction. FBA Section 14 states that a bank will not be licensed, or the license could be withdrawn (under FBA Section 224), if it is associated with a business in such away as to make it difficult to supervise the bank or the group. Although the DFSA has no authority to obtain information directly from, or inspect, a company which it has not licensed, nonetheless it can require the licensed entity to supply that information.
Assessment	Compliant.
Comments	The DFSA has entered into effective arrangements with other supervisory authorities in the region to ensure the consolidated supervision of the major banking groups operating in Denmark. As regards the purely domestic Danish banks, few significant consolidation issues arise due to integrated supervision. As several of the mortgage banks are owned by, or own, commercial banks, the expertise on consolidation issues lies with the Mortgage Credit and Investment Companies Division of the DFSA.
Principle 21.	**Accounting Standards** Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	FBA Section 71, and the guidelines issued by the DFSA under FBA Section 71, require banks to have good accounting systems. The DFSA has the power to specify accounting arrangements which, from 2005, must be consistent with IFRS, as required by EU regulations. Published financial statements must be audited in accordance with these accounting standards and with the additional requirements of the DFSA for banks. FBA Section 188 lists these requirements, which are designed to ensure that financial statements provide a true and fair view of the bank's business and that assets are valued appropriately. Members of the board of directors are responsible for the bank maintaining adequate records and must approve written arrangements for the compiling and maintenance of records. The Board of Directors is also responsible for appointing external auditors, which must meet the

	requirements under FBA Section 199. The DFSA may dismiss the auditor and also has powers to appoint a second auditor. The auditor, besides expressing an opinion on the financial statements for the benefit of the shareholders, is also required to report on certain matters to the DFSA. External auditors must also ensure that banks fulfill their reporting obligations to the DFSA. The EO on Auditing Financial Undertakings and Financial groups specifies the areas to be covered in the auditor's work, including asset quality, valuation of securities and other assets, trading activities, including derivatives, and the adequacy of internal controls. On-site inspections also provide an opportunity to verify the accuracy of statistical reporting and the published financial statements. The DFSA meets with external auditors at the time of on-site inspections. DFSA inspectors view the auditors reports, which must be signed by the board of directors. Where necessary, bilateral meetings can take place on other occasions. Auditors (including internal auditors) have a legal obligation under FBA Section 200 to report to the DFSA matters which are of material importance to the continued operation of the bank that they may observe while performing their audit. This obligation extends to matters that come to their notice in businesses with which the bank may be closely linked.
Assessment	Compliant.
Comments	In the process of adapting to IFRS, some major banks have written back into income provisions made against loan losses, which are not justified under IAS no. 39. This excess provisioning may have reflected a prudent view of potential future losses and could also have been motivated by a wish to defer tax on income, which would have otherwise become payable. The DFSA is contemplating using its powers to raise capital requirements for individual banks to make offsetting adjustments to avoid banks operating with smaller cushions.
Principle 22.	**Remedial Measures** Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.
Description	The DFSA has a range of sanctions available, extending from oral and written comments arising from developments observed during off-site surveillance and on-site inspections, to revocation of the license. In the early 1990s, the DFSA felt the need to develop an instrument which would be available in the early stage of a bank's deterioration. The so-called “bill of health” is an order to the bank under FBA Section 349 to undertake a type of stress test to determine what it would take to breach the minimum solvency requirement. This is typically used for marginally rated banks. Then the DFSA can issue time bound orders under FBA Section 350, where it determines that the interests of depositors are at risk. Such an order could include a requirement that the bank's capital be increased by a specified date. Failure to meet the deadline is grounds for revocation of the license. The DFSA can remove a member of the board of management. It can criticize a specific function in the bank and require the board of directors to take measures. It can order a restriction of certain activities, e.g., new lending. In serious cases it may order, under FBA Section 238, a suspension of payments effectively freezing the business. This would be accompanied by the appointment of a 'supervisor' or conservator. Finally, it may petition the courts under FBA Section 234 to commence liquidation and revoke the license. In the case of minor reporting failures, the DFSA has the power to levy fines. In more serious cases it cannot itself prosecute, but it can refer an infraction to the police, who may initiate prosecutions resulting in fines for individuals or the bank itself, or the imposition of prison sentences of up to four months. Although normally sanctions are not publicized, FBA Section 54A does give the DFSA the authority to publicize action taken against banks in certain

	specified instances. The DFSA has the power to impose sanctions if a bank takes any action likely to imperil the interests of depositors. All remedial actions arising from on-site inspections and other forms of supervision are addressed to the board of directors in writing. The directors are required to sign that they have received the document and the DFSA ensures that the actions are taken within the time limits specified. Failure to do so is grounds for revocation of the license.
Assessment	Largely compliant.
Comments	The DFSA's powers to remove individuals are limited. A member of the management board may be removed but often key members of management, e.g. chief financial officers, are not members of the board and may not be removed. However, the DFSA can require the board of directors to take remedial action in respect a specific function, which may involve management changes. There are no statutory 'prompt corrective action' procedures, but recent changes to the sanction framework has in fact been to enable the DFSA to take action earlier than "Prompt Corrective Action" measures, normally linked to a deterioration in actual solvency ratios, would typically require. There are no powers to restrict dividend payments. However, if such payments would clearly damage depositors' interests, the DFSA would have grounds for action and could prevent the payments. However, the DFSA's performance contract with the government requires that the agency respond to problems promptly and there are internal time limits for processing cases.
Principle 23.	**Globally Consolidated Supervision** Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.
Description	Part 12 of the FBA provides the DFSA with the means to conduct the supervision of banks on a consolidated basis. Under Section 38/1 of the FBA, banks that want to establish a branch in another country shall notify the DFSA of this and require the following information about the branch: • the country in which the branch is to be established; • a description of the activities of the branch, including information on organization and planned activities; • the address of the branch; and • the names of the branch management. According to section of the FBA Section 170–172, the regulations regarding solvency, large exposures, holdings in other companies, holdings in real property, leasing agreements, loans for share capital, liquidity, and exposures within the same group shall apply to the group. The parent undertaking shall ensure compliance with these provisions. The DFSA receives quarterly reports on solo and group basis. In addition, the bank and its banking subsidiaries will provide access to the DFSA inspectors and will cooperate with them. This also applies to foreign entities of Danish banks. A bank shall pursuant to Section 38/7 and Section 40/1/2 of the FBA notify and have a license by the DFSA to establish a branch or a subsidiary in a country outside the EU with which the Community has not entered into an agreement for the financial area. If there is reason to doubt that the administrative structure and financial situation of the bank is reasonable as a basis for the establishment, the DFSA may reject an application for a license. Overseas activities will be regarded as a significant risk area. In major banking groups the overseas entities will be inspected as a part of the special inspection program. According to the inspection program, the DFSA undertakes regular on-site inspections of establishments abroad and receives regular reports from these establishments. Under the FBA, the DFSA has the

	authority to supervise the overseas activities of locally incorporated banks. There exists no provision on the oversight of foreign entities and fit and properness of their bank management have to meet the same requirement as applicable to the head office of credit institutions. Therefore, the DFSA undertakes regular on-site inspections of establishments abroad and receives regular reports from these entities. During on-site inspections of the parent undertaking, the DFSA discusses the overseas establishments with the management. The DFSA gets an impression of the local management during the overseas inspections. The supervisor ensures that management's local oversight of foreign operations is especially intensive when the foreign activities have a higher risk profile and/or when they differ fundamentally from those conducted in the home country, or is conducted at locations that are especially remote from the principal locations at which the bank conducts comparable activities. The DFSA maintains a regular dialogue with management to check its monitoring of the situation in such cases. The overseas establishments will be discussed during on-site inspections in the parent undertaking. The DFSA can withdraw the license of the bank but has no direct authority to require the closing of overseas offices. Where the bank has adopted a policy which the DFSA believes may threaten the solvency or liquidity of the bank, the FBA affords the DFSA the power to require a bank to take any steps it deems necessary. In connection with the regular meetings with the local supervisors, the DFSA gets an impression of the size and type of supervision of the local authority.
Assessment	Compliant.
Comments	
Principle 24.	**Host Country Supervision** A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
Description	The proper supervision of the foreign bank branches/subsidiaries in Denmark, and Danish banks' overseas subsidiaries requires close international cooperation, ideally based on MoUs. The DFSA has signed MoUs with several relevant supervisory authorities and has regular meetings with these authorities, particularly in connection with on-site inspections. Denmark has separate agreements regarding the banking sector with the United Kingdom, France, Germany, Ireland, Netherlands, Hong Kong, the Scandinavian countries, Estonia, and Lithuania. In other cases, the DFSA has informal understandings which permit on-site inspections of foreign branches and the exchange of information with host supervisory authorities. In addition, the DFSA has signed a common Nordic MoU with Sweden, Norway, Finland, and Iceland. Some specific cooperation arrangements are in place with regard to the supervision of particular financial groups. For instance since 2000, the Nordic supervisory authorities have operated a cooperation agreement on supervision of the Nordea Group. Groups focusing on overall risk assessment, insurance, accounting, liquidity, and IT have also been set up. Several Nordic group-wide inspections were conducted through 2003 and 2004 at the Nordea Group. Under Sections 38, 39, and 40 of the FBA, the DFSA is empowered to provide information to host country supervisors concerning the specific offices in the host country, concerning the overall framework of supervision in which the banking group operates. However, the DFSA cannot prohibit banks or their affiliates from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision. But the DFSA can withdraw the license of a bank if legislation in another country outside the EU/EEA-area regarding an undertaking or person with whom the bank has close

	links will complicate performance of the task of the DFSA. There are no problems with secrecy laws inside the EU/EEA-area.
Assessment	Compliant.
Comments	The FBA should require that the DFSA can prohibit banks or their affiliates from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision, even though this has not proved a barrier in practice so far. In addition, a reciprocity clause would seem appropriate.
Principle 25.	**Supervision Over Foreign Banks' Establishments** Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.
Description	The licensing process for foreign bank subsidiaries requires similar procedures as for domestic banks. Under Section 30/4 of the FBA, the DFSA is required to receive a declaration that the activities planned are covered by the company's license in the home country. For credit institutions registered in an EU member state, the application must be routed through the respective home regulator, along with confirmation that the credit institution holds valid authorization or a valid license, etc. Banks that are subsidiaries of foreign banks are subject to similar regulatory requirements applicable to all other Danish banks. Some differences exist, e.g., on restrictions to their activities such as trade in money and credit instruments or E-banking. With regard to branches of banks from outside the EU/EEA, the DFSA retains full supervisory authority, and imposes the same requirements as those applying to domestic banks. At present there are no branches in Denmark of banks from outside the EU/EEA. According to the FBA Section 344/2, the DFSA, for branches of credit institutions licensed in another country within the EU/EEA shall, in accordance with provisions laid down in the Directives, supervise liquidity in such branches. Within the EU/EEA in general, all home country supervisors practice consolidated supervision, which is in line with the EU directives and the texts of the various MoUs. However, it is not a specific condition for obtaining a banking license that the home supervisor practices consolidated global supervision. The sharing of information inside EU/EAA is based on the EU Banking Directive. Confidential information from countries within the EEA shall only be shared where the authorities submitting said information have granted express permission to do so, and said information shall only be used for the purposes specified by said permission. Information may only be exchanged to supervisors outside the EEA: • on the basis of an international co-operation agreement; and • provided that the recipients of said information are, at a minimum, subject to a statutory duty of confidentiality corresponding to the duty of confidentiality pursuant to the FBA and that said recipients require said information to perform their duties. Furthermore, according to Section 346/4 of the FBA, the DFSA may permit foreign financial supervisory authorities to carry out inspections at Danish branches of foreign banks, after prior notification to the DFSA. For local branches and subsidiaries of foreign banks outside the EU/EEA countries, the DFSA has the supervisory responsibility. There is no similar right of access to home country supervisors in the FBA. But the DFSA has up till now never opposed such visits.

	There is no specific provision in the FBA that gives the DFSA the power to advise the home country supervisor of any material remedial action it takes. However, based on the concluded MoUs the host country supervisor is obliged to contact the home country supervisors, if the host supervisor takes remedial action towards a branch. The DFSA does not determine that a foreign entity of a bank incorporated in Denmark is adequately supervised on a consolidated basis.
Assessment	Largely compliant.
Comments	The DFSA is not obliged to require, before issuing a license, approval (or no objection) from the home supervisor. In addition, the DFSA does not assess whether the home country supervisor practices consolidated global supervision. Such requirements are assessed as a helpful tool to practice global consolidated supervision. However, as Danish banks in general have only banking entities inside the EEA, the shortcoming mentioned above will not hinder effective supervision. Concerning local branches and subsidiaries in particular of foreign banks from outside the EU/EEA, the DFSA has supervisory responsibility. There is no similar right of access in the FBA for home country supervisors. But the DFSA has never opposed such visits until now. The DFSA does not advise the home country supervisors on a timely basis of any material remedial action it takes regarding the operations of a bank from that country unless the DFSA has concluded a MoU with the country concerned.

Table 2. Summary Compliance of the Basel Core Principles in Denmark and Other Industrialized Countries

Core Principle	2005 Denmark Assessment						Industrialized Countries[6/] Percent				
	C 1/	LC 2/	MNC 3/	NC 4/	NA 5/		C 1/	LC 2/	MNC 3/	NC 4/	Number[7/]
1. Objectives, Autonomy, Powers, and Resources		x					77	19	3	--	31
1.1 Objectives	x						45	32	23	--	31
1.2 Independence		x					84	13	3	--	31
1.3 Legal framework	x						71	16	10	3	31
1.4 Enforcement powers	x						77	3	3	16	31
1.5 Legal protection	x						65	26	10	--	31
1.6 Information sharing	x						84	13	3	--	31
2. Permissible Activities	x						77	19	3	--	31
3. Licensing Criteria		x					87	10	3	--	31
4. Ownership	x						65	19	13	3	31
5. Investment Criteria		x					71	16	13	--	31
6. Capital Adequacy	x						71	16	13	--	31
7. Credit Policies	x						45	42	13	--	31
8. Loan Evaluation and Loan-Loss Provisioning	x						65	29	6	--	31
9. Large Exposure Limits	x						39	45	13	3	31
10. Connected Lending		x					61	16	16	6	31
11. Country Risk	x						65	19	13	3	31
12. Market Risks	x						48	39	13	--	31
13. Other Risks		x					61	32	3	3	31
14. Internal Control and Audit		x					48	35	13	3	31
15. Money Laundering		(x)					61	26	13	--	31
16. On-Site and Off-Site Supervision	x						71	23	6	--	31
17. Bank Management Contact		x					71	19	10	--	31
18. Off-Site Supervision	x						68	26	6	--	31
19. Validation of Supervisory Information		x					50	33	13	3	30
20. Consolidated Supervision	x						71	23	6	--	31
21. Accounting Standards	x						42	35	16	6	31
22. Remedial Measures		x					64	21	7	7	28
23. Globally Consolidated Supervision	x						57	37	7	--	30
24. Host Country Supervision	x						68	19	10	3	31
25. Supervision Over Foreign Banks' Establishments		x					64	24	10	2	31

1/ C: Compliant.
2/ LC: Largely compliant.
3/ MNC: Materially noncompliant.
4/ NC: Noncompliant.
5/ NA: Not applicable.
6/ Comparison based on 31 assessments of industrialized countries. The figures may not add up to 100 due to rounding.
7/ Some CPs may not be applicable in all jurisdictions.

Recommended action plan and authorities' response to the assessment

Recommended action plan

33. This section lists steps suggested for improving compliance with the BCP or otherwise improving supervisory practice.

Table 3. Recommended Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
Objectives CP 1.1.	A law or a provision formally establishing the DFSA is desirable to make the organization of financial supervision in Denmark more transparent.
Independence CP 1.2.	The DFSA would have more flexibility, if it had its own budget.
Licensing Criteria CP 3/ Internal Control and Audit CP 14/ Remedial Measures CP 22	The "fit and proper" test of the DFSA should ideally apply to holders of other key management positions. It may be useful to develop the guidelines for internal controls to an executive order.
Investment Criteria CP 5	The FBA should require prior approval for investments in non financial companies.
Connected lending CP 10	The DFSA should consider the need for a power to use its discretion to make judgments about the existence of connection between a bank and other parties
Other Risks CP 13	In respect of liquidity, the DFSA should consider introducing the routine monitoring of net funding requirements, stress testing, and contingency planning for possible liquidity crises under various scenarios.
Bank Management Contact CP 17	The DFSA should consider routine meetings with management of banks where on-site inspections are infrequent.
Supervision Over Foreign Banks' Establishments CP 25	The DFSA should consider how to assess the home country supervisory system when they receive an application for a banking license from a bank from a country not represented in Denmark.

Authorities' response to the assessment

With a few exceptions, we are broadly in agreement with the IMF assessment team.

As a follow-up to the recommendations by the IMF team, consideration will be given to establishing the DFSA as an independent institution by providing the agency a statutory basis in the legislation. Correspondingly, a separation of its regulatory and supervisory budget will be considered. In our view, how the budgetary procedure is organized is not the most important issue—instead it is essential to ensure that adequate funds are available at all times. A more distinct division of the budget, where the resources allocated to the supervisory activities are separated, would also give a more clear and transparent overview.

Please note increased resources have been allocated as a consequence of the Capital Requirement Directive and the Third Money-Laundering Directive.

We would also like to emphasize that the DFSA is developing the use of stress tests for monitoring the soundness of financial institutions. The DFSA will take the mission's comments into consideration when further developing these measures. The DFSA, however, notes that building up of the stress testing capacity, such as suggested by the IMF, would require an increase in resources.

The new Basel II capital requirements could indeed—for institutions that apply for the use of the internal rating based approaches for credit risk and advanced measurement approach for operational risk—result in potentially large decreases in the minimum capital requirements. To ensure that any large potential decrease in capital requirement will be gradual, the Danish regulation has included floors that set the maximum decrease in capital requirements for institutions using the advanced methods in 2007, 2008, and 2009 in accordance with the EU Capital Requirement Directive. Furthermore, if other institutions, which are not covered by floors, should experience large decreases in minimum capital requirements that do not reflect the risks that the institution is subject to, the DFSA will have the possibility of setting additional capital requirements in individual cases.

The DFSA will in some cases consider issuing executive orders instead of guidelines. The benefits of such executive orders will have to be viewed against the cost in administration for the supervised entities, but there are definitely supervisory benefits in upgrading the guidelines to legislation. Specifically regarding the recommendation to extend the field of our "fit & proper" regulation to all key staff, and not just board members. However, it also seems an unnecessary burden on the financial businesses if such key staff members should have a "fit & proper" approval in advance. Such measures would also claim a considerable part of resources from the DFSA, and it is, in the DFSA's opinion, doubtful whether the benefits will exceed the costs.

We have the following specific comments on various CPs:

- CP 5: we feel that the DFSA has several criteria by which to judge individual proposals. It is not explicitly stated in CP 5 that the supervisory authority should require prior approval of investments in non-financial companies.

- CP 10: we would like to stress that all connected lending is subject to limits specified in the FBA. We do not see any need for powers to deduct connected lending from capital or to require such exposures to be collateralized. We note that essential criteria 5 to deduct/collateralize connected lending are only examples.

- The DFSA feels that Denmark fulfils the requirements in CP 10.

- CP 13: note that from 2007, banks will be required to hold capital against operational risks. Liquidity risk has currently, and for the last several years, generally been seen as limited, so resources have not been concentrated in this area. The DFSA does plan to enhance its liquidity supervision, in particular with respect to stress testing and contingency planning, as part of its implementation of Basel II.

- CP 17: the allocation of resources combined with the risk-based supervision approach implies that the DFSA only has regular meetings with the senior management of the major banking groups. However, all vulnerable banks (with a rating of 3 or lower) are inspected yearly and in connection with the on-site inspections meetings are held with the senior management of the respective banks.

- CP 25: we would like to stress that Danish banks in general only have banking entities inside the European Economic Area. When the occasion arises, the DFSA will make a consultation to other supervisory authorities, CEBS contacts, or the Group de Contact. The Group de Contact cooperate regarding the work done by supervisors when third country supervisors are evaluated.