GREEN/20/51

July 10, 2020

**Green Statement from Mr. Ronicle and Ms. Andreicut on Denmark—Financial System Stability Assessment (SM/20/99)**

We thank staff for a comprehensive report and Mr. Pösö and Mr. Damgaard for their informative buff statement, providing details of the authorities' views.

We particularly appreciate staff finalizing this assessment during a demanding period; Denmark hosts a systemically important financial sector, with assets over 630% of GDP and a high degree of interconnectedness between financial institutions (domestically and regionally), households and corporates – this FSSA is a timely opportunity to reflect in detail on how such a financial system has weathered the "real-world stress test" of COVID-19.

**COVID-19**

While conscious that the bulk of the FSAP work was conducted prior to the COVID-19 outbreak, we welcome staff efforts to nonetheless reflect developments since. In particular, we found the illustrative scenarios on the possible implications of the COVID-19 shock on bank solvency helpful. We welcome banks' resilience and judge this to be also a reflection of the robustness of the post-crisis financial sector reforms. We also note that liquidity appears to be adequate and that banks could withstand funding pressure more severe than those observed in March 2020.

We welcome staff's overview of Danmarks Nationalbank's (DN) provision of liquidity support in response to the crisis, with DN launching extraordinary liquidity facilities and reactivating bilateral swap lines with the ECB and the Federal Reserve. While financial conditions tightened sharply in March, as was the case for much of the membership, there has been a welcome easing of conditions over recent weeks. Like staff, we encourage the authorities to remain mindful of potential changes in market sentiment and the impact this could have on financial vulnerabilities.

Taken together, the combination of post-crisis reform and swift liquidity provision have allowed the Danish financial system to absorb the COVID-19 stress and continue to deliver its primary function of providing credit to the real economy, supporting economic activity in the face of a substantial negative economic shock.

**Progress since 2014 FSAP**

We commend the authorities for progress made in addressing the 2014 FSAP recommendations, in particular managing risks related to mortgage credit institutions, implementing international insurance standards and recent AML / CFT supervision reforms. We note however that the report identifies several weaknesses in the implementation of previous FSAP recommendations. While Box 2 is helpful in specifically addressing money laundering concerns in relation to Danske Bank and table 3 provides additional color on the full set of recommendations, staff could have provided further detail on outstanding actions. This would help us better understand how the authorities will respond to the 2020 recommendations and how to increase the traction of FSAPs in general. This is particularly relevant for the recommendation on which no progress has been made (ensuring operational independence of the Danish Financial Supervisory Authority-DFSA-) and which is repeated as a recommendation in the current FSAP.

**Emerging risks**

In the context of the ongoing FSAP review, which aims to better capture emerging risks, we very much welcome staff's coverage of climate risks. We found the assessment of the greater exposure of the Danish banking sector to physical than to transition risks helpful. Staff note that although 1½ percent of mortgage assets serving as collateral are currently at risk of flooding, this share could increase to 13 percent. We would have found helpful a discussion of the potential timing of risk materialization and possible contingency measures.

Staff also note that transition risks are relevant for smaller banks with large exposures to the agricultural and energy sectors. We would have welcomed additional detail here, as well as a sense of the share over the overall financial sector constituted by these banks. Finally, we hope that in future climate assessments will be more fully incorporated into the main body of the report, rather than mostly dealt with in annexes.