DET SYSTEMISKE RISIKORÅD

21 March 2017

The Council's work

The Council's work concerning systemic risks is made up of three parts. The Council monitors the financial system, makes recommendations on policy measures and evaluates policy measures. A risk is considered systemic to the financial system, if its materialisation can impact significant parts of or the entire system. This increases the risk of a financial crisis.

What does the Council do?	
Part 1	**The Council monitors risks in the financial system as a whole** ▪ The Council comprises a broad range of expertise with participation of independent experts as well as top level officials from Danmark's Nationalbank, the Danish Financial Supervisory Authority, the Ministry of Industry, Business and Financial Affairs, Ministry of Economic Affairs and the Interior and the Ministry of Finance. ▪ Every quarter, the Council takes stock of recent developments in the financial system. The Council reviews a number of areas that may involve systemic risks, such as excessive growth in lending to households and the corporate sector. ▪ The Council conducts in-depth analyses of selected topics, e.g. the impact on the financial system of financial obligations between Danish financial corporations and of a cyber-attack.
Part 2	**The Council makes recommendations on policy measures on a "comply-or-explain" basis** ▪ The Council can issue recommendations regarding financial policy measures, e.g. to the government. Recommendations must either be implemented (comply) or the addressees must explain to the Council why they are not being implemented (explain). Furthermore, the Council may e.g. issue observations if it assesses that systemic risks may be building up, but that there is not yet a need for specific policy measures. The Council has, inter alia, recommended imposing restrictions on mortgage loans with deferred amortisation and has issued observations about low interest rates. ▪ Each quarter, the Council assesses whether it should recommend policy initiatives in order to mitigate or counter specific systemic risks. The Council issues a press release after each meeting, summarising the Council's risk assessment and outlining central discussions. ▪ The Council conducts analyses of possible initiatives in order to prepare eventual future recommendations. For example, the Council has developed a method to assess the need for imposing countercyclical capital requirements in Denmark.
Part 3	**The Council assesses whether the follow-up on its recommendations is sufficient** ▪ The Council assesses whether the follow-up on its recommendations is sufficient. If a recommendation has not been implemented, the Council assesses the implications for systemic risks.

Part 1 – The Council monitors risks in the financial system as a whole

The Council takes stock of developments in the financial system every quarter. The Council reviews a diverse data set covering lending trends, the credit institutions' financing requirements, etc. The data set is used to illustrate a number of areas that may involve systemic risks. For example, increased risk appetite or overoptimism among lenders, firms and households may result in excessive growth in lending and leverage that could reinforce an upswing and the subsequent downturn. The risk areas are described in the memo Monitoring of systemic risks. The Council focuses on the financial system as a whole rather than individual institutions – unless the institutions affect the entire system due to their size or complexity.

The Council supplements the risk review with in-depth analyses of selected topics that may affect financial stability. The Council has taken a closer look at the impact on the financial system of financial obligations between Danish financial corporations, at the increased use of collateral in the form of repo transactions etc. and at cyber-attacks as a systemic threat, among other issues.

Part 2 – The Council makes recommendations on policy measures on a "comply-or-explain" basis

The Council issues recommendations regarding initiatives in the financial area that are to be taken well before a crisis may set in, so that systemic risks are prevented or the risks can be addressed. Alternatively, the Council may publish observations or warnings if closer monitoring is required, but specific policy measures are not yet needed. Specific crisis management initiatives and e.g. fiscal and tax policy are beyond the Council's mandate.

Since its establishment in 2013, the Council has issued two recommendations and two observations. The recommendations concerned restriction of deferred amortisation on mortgage loans and phasing-in of capital requirements legislation in Denmark. The observations concerned the low interest rates and the risk of systemic risks building up, since the very low interest rates may induce borrowers and financial players to assume excessive risk.

Each quarter, the Council assesses whether there is a need for policy measures. The Council issues a press release after each meeting, summarising the Council's risk assessment and outlining central discussions.

The Council conducts analyses of possible initiatives in order to prepare eventual future recommendations. For example, the Council has developed a method to assess the need for imposing countercyclical capital requirements in Denmark, also known as the countercyclical capital buffer. The method is a three-stage decision-making process. Initially, the Council assesses the development in a number of key indicators; then it takes into account other relevant information. Finally, the Council concludes what the appropriate level of the countercyclical capital requirement should be. The Council has also discussed other possible initiatives; see the overview below. Other countries similar to Denmark are also in the process of building up expertise in preventing and limiting systemic risks.

Part 3 – The Council assesses whether policy measures are sufficient

The Council assesses how the government – or other recipients of a recommendation – follow up on recommended initiatives. Recommendations must either be implemented or the addressees must explain to the Council why a recommendation has not been complied with. As a main rule, both the recommendation and the eventual explanation will be made public. The Council's assessment must consider whether the follow-up is sufficient. The Council's assessment of the government's follow-up on its recommendations to phase in capital requirements and regarding mortgage loans with deferred amortisation is stated in the Council's press releases (see assessment of follow-up on phasing-in of capital requirements and assessment of follow-up on mortgage loans with deferred amortisation).

The Council's discussions of policy initiatives	Table 1
Risk area and policy initiative	Discussion in the Council
1: Excessive credit growth and leverage	
Capital requirements:	
▪ Countercyclical capital buffer	Regularly. Methodology paper from December 2014
▪ Sectorspecific requirements	June 2015
▪ Leverage ratio	March 2015
Borrowing restrictions:	
▪ Limits on loan-to-income (LTI), debt-service-to-income (DSTI) and loan-to-value (LTV)	September 2014, September 2015
▪ Amortisation requirements	March, June and September 2014 Recommendation from September 2014
2: Excessive maturity mismatch and market illiquidity	
Stable funding requirements	
▪ Net Stable Funding Ratio, NSFR	Recommendation from June 2013
Liquidity requirements	Recommendation from June 2013
3+4: Direct and indirect exposure concentrations	
Capital requirements for large exposures Large exposure restrictions	
5: Systemically important financial institutions	
Capital requirements for systemically important financial institutions, SIFI's	Recommendation from June 2013

Source: Gross list of instruments based on The European Systemic Risk Board, The ESRB Handbook on Operationalising Macro-Prudential Policy in the Banking Sector, 3 March 2014.