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Political Agreement on Financial Stability, October 5, 2008

Danish Government: Ministry of Economic and Business Affairs

Danish Government: Ministry of Finance

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Ministry of Economic and Business Affairs
Ministry of Finance

The text is to be regarded as an unofficial translation

Political Agreement on financial stability

The international financial crisis has affected financial markets in Denmark, frozen the money market and severely impeded the access to liquidity for many banks.

The situation is regarded with great concern given the international market-failure where even healthy banks are having trouble getting access to liquidity. This threatens financial stability in Denmark and if unaddressed may cause significant disruptions to firms and households.

The Parties therefore agree that the state together with the financial sector (Det Private Beredskab) will extend a safety net so that all claims by depositors and other ordinary creditors are fully covered. This will safeguard financial stability by contributing to facilitate the resumption of interbank lending. The need for this initiative should also be seen in the context of the relatively fragmented banking sector in Denmark.

It is a key requirement that the financial sector take the lead by assuming responsibility. It has been agreed that the financial sector (Det Private Beredskab) will contribute up to 35 bn. DKK or the equivalent of 2 percent of GDP. The state will provide an additional guarantee and establish a company with the purpose of facilitating the winding-up of insolvent banks so that depositors and other ordinary creditors do not suffer losses on their claims against insolvent banks. The scheme will run for two years with the possibility of an extension if financial stability concerns necessitate its continuation.

The Parties stress that the banking industry must complement the safety by displaying a cautious approach and strengthening their balance sheets during the two year period. Therefore, the safety net is combined with a ban on dividend payments and share repurchases by banks as well as new stock options for management. Expiring stock option programmes must not be renewed or extended.

In order to alleviate liquidity stress, the Danish National Bank had launched a number of new lending facilities involving further lending against collateral. Under these facilities, banks may access funding by pledging as collateral shares etc. as well as solvency in excess of the statutory requirements of solvency. As part of the safety net, the National Bank will establish a new lending facility for solvent banks.

The Parties further agree that the resources of the Financial Services Authority need to be strengthened. The additional resources will be employed in bank supervision.

Specifically, The Parties agree that:

1. The Government (the Ministry of Economic and Business Affairs) shall establish a winding-up company by law to ensure that investors and other ordinary creditors do not suffer any losses in banks and savings banks (hereafter banks).

In case a bank does not fulfil the statutory requirements of solvency, and there is no possibility to reach a viable private solution, the winding-up company will provide capital to a newly-established company which will take over and wind up the bank in a controlled fashion, so that ordinary creditors do not suffer any losses.

The winding-up company will also have to guarantee ordinary creditors in full in the event of a banks bankruptcy.

The winding-up company will continue its business after the expiration of the arrangement, as the winding-up of distressed banks is time-consuming.

2. An Agreement has been made between The Government and banks (the members of Det Private Beredskab), where by The Government has guaranteed ordinary creditors against losses due to banks to the extent that the losses are not covered by the Deposit Guarantee Scheme, other investor arrangements, or covered by other means (e.g. covered bonds and debt and deposits with collateral in government bonds or covered bonds).

3. The Agreement covers all banks in the Kingdom of Denmark with a banking licence which are members of Det Private Beredskab.

For foreign branches of banks in countries with a similar guarantee arrangement, the bank may allow the branch to be covered.

4. Branches in Denmark of foreign banks can receive coverage for investments from investors of a type covered by the Danish Deposit Guarantee Scheme, in case they are not covered by a similar arrangement in their country of origin. This is in order to avoid competitive distortions on the Danish market. If the occasion should arise, depositors are covered in full with deductions for coverage in the particular Deposit Guarantee Scheme. The winding-up company will be granted a legal basis to ensure this.

5. Entry and withdrawal from Det Private Beredskab will be possible for a short period of time after the announcement of the arrangement.

It must be ensured that no banks are established or branches of foreign banks with the aim of speculating on the arrangement.

6. The arrangement will continue until 30 September 2010 with the possibility of prolongation, if considerations of financial stability necessitate a prolongation.

7. The statutory Deposit Guarantee Scheme is not affected by this arrangement.

8. Det Private Beredskab will provide a guarantee for DKK 10 billion to cover losses in the winding-up company or pursuant to an agreement with the Government by other means. Moreover,

Det Private Beredskab will pay a market conform guarantee commission amounting to DKK 7,5 billion annually to the winding-up company.

9. After the expiration of the arrangement, the value in the winding-up company is calculated. On that basis possible losses of the winding-up company are calculated.

If the estimated losses including interest on provided capital of the winding-up Company exceed the provided guarantee and the paid guarantee commission of Det Private Beredskab, Det Private Beredskab shall cover additional losses for the amount of maximum DKK 10 billion via an increased guarantee commission.

The combined contributions from Det Private Beredskab in the form of a guarantee commission and guarantee against losses shall therefore amount to a maximum of DKK 35 billion over the two years.

10. Any surplus in the winding-up company will go to the central government.

11. Det Private Beredskab will decide for itself the apportionment of the guarantee commission to the individual banks. Det Private Beredskab has decided that the specific institution's obligations and loss guarantee will be calculated in relation to the particular institution's necessary base capital, which can be assigned to activities which are covered by the guarantee. The commission is collected on a monthly basis. At the request of an individual bank, the commission may be paid in the form of shares and written guarantees issued by the institution.

12. Banks participating in the arrangement may not pay out dividends or create new redemption programmes whilst the arrangement is in force.

13. Banks participating in the arrangement may not initiate new share purchase programmes whilst the arrangement is in force, and existing share purchase programmes must not be prolonged or renewed.

14. The following conditions are set for the banks in Det Private Beredskab:

A requirement to provide a declaration according to § 246 of the Danish Financial Business Act, whereby the institutions commit themselves to sell the institution to a buyer selected by the winding-up company, if the institution does not fulfil the statutory requirements of solvency. During a transfer of assets and liabilities of the bank except subordinate capital and net capital to the winding-up company or to a subsidiary owned by the winding-up company, it must be ensured that the owners of risk capital are not taken into consideration by the Government guarantee, as share capital, hybrid core capital and supplementary capital will remain with the bank, whilst all other commitments will pass on to the winding-up company.

The banks must accept that the Danish Financial Supervisory Authority may deny an institution's request to transfer liquidity to other companies within the same conglomerate by reference to the safeguard of the arrangement.

It is not possible for a particular bank to withdraw from the agreement.

Banks participating in the arrangement may not undertake mass marketing of the fact that the ordinary creditors are now ensured against losses. This corresponds to the understanding which exists in respect of the Deposit Guarantee Scheme and does not exclude a description of the arrangement on the web site of the individual bank.

Banks participating in the arrangement may not undertake a significant expansion of their activities which would not have taken place in the absence of the arrangement.

Det Private Beredskab commits itself to inform the Financial Supervisory Authority if circumstances are discovered amongst its members which point towards a speculation on the arrangement. For instance, if a bank displays extraordinary behaviour, which appears to be speculation in the arrangement by having business activities that deviate from normal practice.

15. If a bank displays extraordinary behaviour, which appears to be speculation in the arrangement for instance by having business activities that deviate from normal practice, the Danish Financial Authority can issue an order that will be made public. If a bank does not comply, the Financial Supervisory Authority can expel the bank from the arrangement.

16. The resources to The Financial Supervisory Authority will be increased by 10 mio. DKK.

17. The Central Bank of Denmark has announced that it will set up a special liquidity facility, where Banks can get liquidity at an extraordinary high interest rate.

Finally, the parties agree that after the expiry of the present agreement there is a need to examine the design of permanent financial regulatory system, including::

- The solvency and risk profiles of banks should be more transparent. Further the parties agree to work for greater transparency of bank risks in EU Member States.
- On a number of occasions, banks have aggressively marketed their own shares to retail customers. A working group under the Danish Financial Services Authority is currently looking into the customer advice practices of bankTrelleborg and Roskilde Bank regarding purchases of shares in the banks. Based on the reporting of the working group, regulation in this area will be tightened so as to limit further sales of own shares to bank customers.
- Financial sector institutions are subject to a special regulatory regime because they play a special role on the economy at large and because they manage the funds of depositors. Therefore, incentive structures embodied in management compensation is particularly important in the financial sector. There is a need to tighten rules regarding the use of stock option programmes in order to limit variable pay components.
- The parties take note that the National Audit Office will examine the supervisory work of the Financial Services Authority in relation to, among others, Roskilde Bank and bankTrelleborg.

- As previously agreed by the parties behind the agreement on covered bonds, an analysis of how the introduction of covered bonds has affected consumer choice in housing finance and competition in the financial industry will be carried out.
- The future set-up of The Deposit Guarantee Scheme

The Parties will follow future developments.