

MEMORANDUM

The Danish Financial Supervisory Authority

11 November 2022

Statement on inspection of Danske Bank (home loans for owner-occupied and holiday homes)

Introduction

In May 2022, the Danish Financial Supervisory Authority (the Danish FSA) conducted an inspection of Danske Bank's risk appetite when approving home loans for customer purchases of owner-occupied and holiday homes in the second and third quarters of 2021.

The Danish FSA also examined whether the bank's approvals complied with the Danish Executive Order on Good Practice in Mortgage Credit in relation to high-risk home loans and requirements for customers' own financing and whether the customers' finances were sufficiently robust pursuant to the Danish Executive Order on Management. The inspection therefore also looked at whether home loans in growth regions were approved in accordance with the growth guidelines or whether other requirements for the robustness of customer finances had been imposed. Another purpose of the inspection was to assess the bank's own controls of and reporting in the area.

Summary and risk assessment

The Danish FSA reviewed the bank's credit policy, relevant business procedures and reports. The Danish FSA also reviewed 78 sampled approvals of home loans for purchases of owner-occupied homes in growth regions, 50 sampled approvals of home loans for purchases of owner-occupied homes outside growth regions and 20 sampled approvals of home loans for purchases of holiday homes. The approvals were selected among customers with a debt-to-income ratio of more than 3.5 and an LTV ratio above 60%.

The bank had introduced two exceptions in relation to the approval of high-risk loans that were not in accordance with the rules on good practice. The Danish FSA has ordered the bank to change this practice.

On the basis of the sample of approvals, the Danish FSA assessed that 9-14% of the bank's total approvals of customer purchases of homes in growth regions in the second and third quarters of 2021 were imprudent and thus did not comply with the Danish Executive Order on Management. The reason for the high number was primarily that the amount available for consumption was not sufficient.

For 10% and 20%, respectively, of the selected approvals of customer purchases of owner-occupied and holiday homes outside growth regions, the Danish FSA assessed that the amount available for consumption after the purchase was not sufficient for the customer. This was mainly due to the fact that the bank's material did not provide any reason to conclude that the customers would be able to withstand the very large fall in the amount available for consumption caused by the purchase of the home.

For 5% of the selected approvals, the bank had approved high-risk loans without ensuring that the customers were subject to a possible exemption according to the rules on good practice in mortgage credit. This was due in part to the bank's incorrect implementation of the rules. This is a higher percentage than that of other large banks inspected by the Danish FSA.

In a number of cases, the bank had approved home loans for customers with negative net worth, zero net worth or slightly positive net worth. The lack of robustness in terms of net worth was not offset by

the customers' repaying their debt faster and thus being able to build an amount of net worth within a short period of time that could withstand a decline in the house price of at least 5% while leaving the net worth positive.

On the basis of the above-mentioned inadequacies, the Danish FSA has ordered the bank to ensure that the robustness of customer finances is sufficient when it approves home loans, including ensuring that the stipulations of the growth guidelines are complied with or that the bank in other ways has ensured an appropriate basis of credit, that the amount available for consumption is sufficient, that no high-risk loans are approved without customers being subject to a possible exemption, and that customers' net worth is not low without compensating measures.

There were many errors and inadequacies in the basis for decision-making, including in particular in the calculation of the amount available for consumption. In several cases, the decrease in the amount available for consumption after the customer's purchase of a home was larger than that calculated by the bank. In addition, the bank's analysis of whether the decrease in the amount available for consumption after the purchase was realistic for the customer did, in some cases, give a false impression. This was due to the bank's method of calculating the customer's previous ability to save up. This fact and the many errors contributed to the Danish FSA's conclusion that the amount available for consumption was not sufficient in a number of cases. This also entails a risk that the bank will make incorrect credit decisions and that parts of the management reporting will be misleading. The Danish FSA has ordered the bank to ensure that the analysis of the decrease in the customers' amount available for consumption is improved.

The Danish FSA's review of the bank's controls and reports showed that a high level of errors in the basis for decision-making had been identified and reported for a long time. The bank had taken various measures to reduce the number of errors, but the Danish FSA's inspection showed that the measures had not yet had the necessary effect. The bank will follow up to ensure that the measures taken to reduce the number of errors and any other measures have the necessary effect so that approvals for personal customers are based on correct data.