

The Board of Directors and the Executive Board of  
Danske Bank A/S

Forwarded by e-mail  
cc The auditors of the bank

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The Danish Financial Supervisory Authority

## **Danske Bank's follow-up on the Danish Financial Supervisory Authority's decision in the Estonia case of 3 May 2018**

On 29 June 2018, the Danish Financial Supervisory Authority (the FSA) received the bank's response with follow-up on the orders and reprimands contained in the FSA's decision of 3 May 2018 on the bank's management and governance in relation to the AML case at the Estonian branch.

For each order, the Board of Directors and the Executive Board of the bank have accounted for the initiatives taken in order to comply with the order. As stated in the decision of 3 May 2018, Group Internal Audit must submit relevant documentation to the FSA once Group Internal Audit has determined whether the orders have been complied with.

According to its decision of 3 May 2018, the FSA finds the following to be particularly worthy of criticism:

- *“that there were such significant deficiencies in all three lines of defence at the Estonian branch that customers had the opportunity to use the branch for criminal activities involving vast amounts.*
- *it was not until September 2017 that the bank initiated an investigation into the extent of suspicious transactions and customer relationships as a result of the insufficient handling of AML at the branch, that is, more than four years after the termination by one of the branch's correspondent banks of its correspondent bank relations and almost four years after the whistleblower report.*
- *that with the exception of the termination of the cooperation with Russian intermediaries, the bank deferred the decision to close down the part of the non-resident portfolio that related to customers who did not have personal or business-related links to the Baltic countries until January 2015, and that the close down was not completed until January 2016.*
- *that the bank's governance in the form of internal reporting, decision-making processes and corporate culture failed to ensure that the problems of the non-resident portfolio were sufficiently identified and handled in a satisfactory way, including by reporting suspicion of criminal activities to relevant authorities. This applies to both the period up until the close down in early 2016 as well as the period since the beginning of 2017.*
- *that the bank did not inform the Danish FSA of the identified AML issues, even though in early 2014, it should have been clear to some Executive Board members and other senior employees that the information previously provided by the bank to the Danish FSA and the Estonian FSA in 2012 and 2013 was misleading and that it should have been clear to them that the supervisory authorities focused on the area.*
- *that the bank's information to the Danish FSA since the beginning of 2017 has been inadequate.”*

According to the bank's report published on 19 September 2018, the bank also in 2007 submitted incorrect information to the FSA in connection with an inquiry from the Russian central bank.

This decision contains the FSA's supervisory reaction as follow-up on assessments of whether the bank can be considered to comply with the orders of 3 May 2018. The decision has been considered by the Governing Board of the FSA.

This decision does not contain the FSA's assessment of the bank's own investigations into management's handling of the case. Following the conclusion of the bank's own investigations into the case, the FSA has initiated an assessment to establish whether the basis underlying the decision of 3 May 2018 has changed and may warrant new supervisory reactions. The FSA will at a later point in time approach the bank about this.

### **Summary and order**

As regards the order on reassessment of the solvency need (Order no. 2), the FSA considers that at 30 June 2018, the bank complied with the order to increase its solvency need by a Pillar II add-on of DKK 5 billion. Considering the developments since 30 June 2018, the FSA assesses the bank's compliance and reputational risks to be higher than prior to the FSA's decision of 3 May 2018.

Consequently, with this decision, the FSA issues the following order to the bank's Board of Directors and Executive Board:

- With reference to section 124(1)-(2) of the Danish Financial Business Act, the FSA orders the Board of Directors and the Executive Board to reassess the bank's and the banking group's solvency need in order to ensure an adequate capital coverage of increased compliance and reputational risks.

By 25 October 2018, the Board of Directors and the Executive Board must submit a written report to the FSA stating how the bank has ensured compliance with the order.

Any relevant documentation must be enclosed.

As part of the ordinary cooperation with the other supervisory authorities involved in supervising the banking group, the FSA will assess the size of an increased Pillar II add-on to the solvency need. When reassessing the Pillar-II add-on, the bank must seek to ensure a prudent calculation. The FSA initially estimates that, as an absolute minimum, the bank should increase the Pillar II add-on to DKK 10 billion, equivalent to about 1.3% of the REA (risk exposure amount) at the end of the second quarter of 2018. Moreover, the FSA is of the opinion that the bank must fund the Pillar II add-on through common equity tier 1 capital.

When the Pillar-II add-on has been determined, the bank must make sure that the relevant adjustments of the Group's capital plan are made, including adjustments of capital targets and share buy-back programmes.

The bank does not fully comply with Order no. 5 since the response does not comprise initiatives in relation to the part about ensuring satisfactory documentation of the decision-making basis, discussions at meetings and decisions made. The bank's Board of Directors and Executive Board must therefore account for initiatives taken with a view to generally strengthening the bank's governance in relation to decision-making processes, including governance at levels below the Board of Directors and the Executive Board.

In relation to the remaining orders of the decision of 3 May 2018, the FSA finds that the bank either had complied with the orders by the end of June 2018 or has initiated suitable initiatives to ensure compliance.

As regards some orders, it will not be possible for the FSA to determine with certainty whether the bank has complied with them until the bank's initiatives have been implemented in full. This applies, for example, to the establishment of new or changed processes as well as the development and implementation of functionality in IT systems. The bank expects the initiatives taken to comply with the orders to be implemented by the end of 2018/beginning of 2019.

Furthermore, as regards some orders, adjustments to governance processes also need to feed through to the bank's governance culture and thus the bank's conduct. The FSA is of the opinion that this may take some time.

The FSA will monitor the bank's implementation of the initiatives and developments in its governance culture.

Given that changes in the governance culture and corporate culture and the restoration of the bank's reputation have a longer perspective, the FSA expects the bank's compliance and reputational risks to be increased in coming years. In cooperation with the other supervisory authorities involved in supervising the banking group, the FSA will, on an ongoing basis, monitor developments and regularly jointly assess the bank's and the banking group's solvency need.

#### **1. The bank's follow-up on the FSA's orders of 3 May 2018**

In the following and for each order, the FSA assesses the bank's compliance with the orders stated in the FSA's decision of 3 May 2018

- 1) *“With reference to section 71(1) of the Danish Financial Business Act and section 2 of the Executive Order on Management and Control of Banks etc., the FSA orders the Board of Directors and the Executive Board to strengthen the Executive Board's governance with regard to competencies in the compliance area and at the same time ensure that, on the Executive Board, the area responsibilities for compliance are sufficiently independent of business and profitability interests.”*

For one thing, the order reflects this conclusion in the decision of 3 May 2018:

*The bank's management has not ensured sufficient focus on the compliance area and transparency of the issues nor has it ensured a timely and reassuring handling of potential issues of complying with legislation.*

The bank has hired an experienced compliance officer, who will become part of the Executive Board.

The FSA is of the opinion that through this initiative, the bank complies with the order. The FSA will monitor how the Executive Board's governance and work in the compliance area progresses.

- 2) *“With reference to section 124(1)-(2) of the Danish Financial Business Act, the FSA orders the Board of Directors and the Executive Board to reassess the bank's and the banking group's solvency need in order to ensure an adequate internal capital coverage of compliance and reputational risks as a result of weaknesses in the bank's governance.”*

For one thing, the order reflects these conclusions in the decision of 3 May 2018:

*“The bank's governance in the form of internal reporting, decision-making processes and corporate culture failed to ensure that the problems of the non-resident portfolio were sufficiently identified and handled in a satisfactory way. This applies to both the period up until the close down in early 2016 as well as the period since the beginning of 2017.”*

*Management's priorities and means of conduct have damaged the credibility and reputation of the bank. Considering the bank's systemic significance and international presence, the reputation of the Danish sector of financial institutions may be damaged as well.*

In its response, the bank recognised the need for a Pillar II add-on to its solvency need to ensure adequate capital coverage of its compliance and reputational risks as a result of the weaknesses identified in the bank's governance. The bank found that a Pillar II add-on of DKK 5 billion, or 0.7% of the risk exposure amount (REA), at 30 June 2018 would be an appropriate level to cover these risks.

Upon receiving the response, the FSA asked the bank to send further information about the bank's assessment, including by quantifying the risk of fines, confiscation of earlier profits and potential civil lawsuits.

The FSA considers that at 30 June 2018, the bank complied with the order to increase its solvency need by a Pillar II add-on of DKK 5 billion. Considering developments since 30 June 2018, the FSA assesses the bank's compliance and reputational risks to be higher than prior to the FSA's decision of 3 May 2018.

In the FSA's decision of 3 May 2018, it was stated that the total flow of transactions going through the Estonian branch was very extensive considering the branch's high earnings on the non-resident customers. Subsequently, the bank's own investigation has shown that the total flow of transactions from non-resident customers through the Estonian branch amounted to approx. EUR 200 billion. At the time of the publication of the findings of the investigation on 19 September 2018, the bank had investigated approx. 6,200 of the approx. 15,000 non-resident customers comprised by the bank's own investigation. Of these 6,200 customers, almost all of them had been – or will be – reported to an FIU in consequence of suspicious activity. According to the bank, it is likely that more customers will be reported to an FIU in consequence of the outstanding investigation of the remaining non-resident customers comprised by the bank's own investigation.

Both the Danish Public Prosecutor for Serious Economic and International Crime (SØIK) and the corresponding Estonian police authority (Financial Intelligence Unit – FIU) have subsequently initiated investigations into the matter.

The value of the bank – measured by share price – has decreased significantly, and the bank's credit spreads and interest rate spreads have widened.

The bank's reputation has deteriorated further, and there is a risk of changes in customer behaviour.

Furthermore, the bank's management has been weakened, and this entails an increased risk of inadequate implementation of the necessary changes to the bank's governance, compliance and corporate culture.

The FSA's decision of 3 May 2018 thus included significant criticism of various functions headed by four members of the bank's Executive Board and seven other members of senior management. This criticism led to a number of serious reprimands to the bank as a consequence of these functions' reproachable discharge of their responsibilities.

When the FSA initiated its investigation of Danske Bank's management and governance in relation to the AML case at the Estonian branch in September 2017, two Executive Board members and three of the other members of senior management were still with the bank.

These members have left the bank in 2018 or have announced that they will leave in the near future. Subsequently, the 11 Executive Board members and other employees with management responsibility for the criticised functions will no longer be working at the bank.

The FSA assesses that developments since 30 June 2018 warrant a higher Pillar II add-on to the solvency need. This is the reason for the order stated in the Summary and order section above.

- 3) *“With reference to section 71(1) of the Danish Financial Business Act and section 17(1) of the Danish Executive Order on Management and Control of Banks etc., the FSA orders the Board of Directors and the Executive Board to ensure that when there is suspicion of the bank’s managers or employees colluding with customers in criminal activities or knowing of customers’ criminal activities, the bank conducts adequate investigations and takes the suspicion into consideration on an ongoing basis when allocating tasks to these managers or employees.”*

For one thing, the order reflects this conclusion in the decision of 3 May 2018:

*In the period after the whistleblower report, there were several indications that members of the management and/or employees of the branch were colluding with customers in criminal activities or, at least, knew of such activities. The bank did not, however, investigate this, and there were no managers or employees who were dismissed or relocated as a result of such a suspicion.*

As stated in the bank's report, which was made public on 19 September 2018, the bank's investigations have subsequently led to the bank reporting eight former employees to the Estonian police and submitting SARs (suspicious activity reports) in respect of 42 former and current employees as well as former agents.

In its response, the bank has described the organisational units which are responsible for conducting the internal investigations into suspicions of potential criminal activity, and points to a strengthening of the setup, most recently with the establishment of a unit (in December 2017) responsible for investigating large and complex compliance events.

As a consequence of the order, the bank has prepared written business procedures that describe the process for handling suspicions of criminal activity and the elements of related internal investigations.

Further, the bank has initiated the implementation of system-supported functionality in the HR system in order to ensure that managers are informed when an employee’s tasks should be limited in the event of a suspicion and ongoing internal investigation. The bank expects this to be implemented in the second half of 2018.

The FSA is of the opinion that through this initiative, the bank complies with the order. The FSA will monitor the bank’s implementation of the initiatives.

- 4) *With reference to section 71(1) of the Danish Financial Business Act and sections 3(vi) and 8(3) of the Danish Executive Order on Management and Control of Banks etc., the FSA orders the Board of Directors and the Executive Board to strengthen the bank’s governance in order to ensure accurate and timely reporting of potentially problematic cases to the Board of Directors and the Executive Board.*

For one thing, the order reflects this conclusion in the decision of 3 May 2018:

*“The bank’s governance in the form of internal reporting, decision-making processes and corporate culture failed to ensure that the problems of the non-resident portfolio were sufficiently identified and handled in a satisfactory way. This applies to both the period up until the close down in early 2016 as well as the period since the beginning of 2017.”*

In its response, the bank has mapped a number of written policies and business procedures covering internal rules for escalation and reporting. As a result of the order, the bank has decided to prepare a

new policy for internal escalation to outline the overall principles and standards for timing, responsibility, processes and requirements for accuracy etc. for escalating matters to the Executive Board and the Board of Directors. The new policy will be operationalised in the form of adjustments to existing business procedures etc. The bank expects the new policy to be ready in the third quarter of 2018. The FSA will monitor the bank's implementation of the initiatives.

The bank has also emphasised that each of the Executive Board members, in his or her area of responsibility, is under an obligation to report any significant irregularities to both the CEO and the chairman of the Board of Directors. This is not new.

In its reply in relation to the order to ensure sufficient involvement of the Board of Directors and the Executive Board in written responses to requests from the FSA (Order no. 8), the bank has also noted that the Executive Board and/or the Board of Directors will be informed about possible problems etc. when they are involved in replies to the FSA.

The Board of Directors and the Executive Board must be aware that the background to this order and the bank's compliance in this respect, in practice, extend beyond setting up written policies and business procedures. To a great extent, this is also a question of management and corporate culture in that the bank must ensure that it is both expected and appreciated that employees point out possible problems. At the same time, there is also a need to ensure that management responds to information about possible problems and takes sufficiently critical follow-up action to check that problems are appropriately addressed.

Escalation of possible problems should generally take place and be handled by management internally at the bank before they develop into actual issues – both internally and in relation to the authorities.

The FSA finds that the bank's initiatives appear to be relevant for the purposes of complying with the order. However, the bank must pay attention to the broad aim of ensuring early escalation and sufficient management handling of possible problems as a fully integral part of the bank's governance culture. The FSA cannot make a final decision until the new escalation policy has been drawn up and has been operationalised in the bank's processes.

- 5) *“With reference to section 71(1) of the Danish Financial Business Act and sections 2 and 14(1) of the Danish Executive Order on Management and Control of Banks etc., the FSA orders the Board of Directors and the Executive Board to strengthen the bank's governance in order to ensure that the basis for decisions as well as discussions at meetings and decisions made are sufficiently documented and that sufficient attention is given to the bank's compliance with applicable legislation.”*

For one thing, the order reflects this conclusion in the decision of 3 May 2018:

*The FSA's review of the case has shown that the Board of Directors', the Executive Board's and the bank's other decision-making processes have not been sufficiently documented through comprehensive written decision-making memos, minutes of discussions and minutes of decisions. Furthermore, assessments of compliance risks have not been sufficiently included in or been given adequate importance in the decision-making processes.*

*The absence of sufficiently documented decision-making processes has contributed to the bank's Board of Directors and Executive Board not being able to answer questions from the FSA on a number of issues, but have referred to the need for further internal investigations. By virtue of the normal discharge of management's responsibilities and tasks, the Board of Directors or the Executive Board ought to have had the information necessary or be able to obtain such quickly. This applies in particular in a case like this which has attracted considerable external attention since early 2017, and in respect of which the bank has thus had plenty of time to gain an overview of key elements.*

In its response, the bank has assessed that it generally complies with the applicable rules for documentation of discussions at meetings and decisions made in the form of minutes. As a result of the order, the bank has reviewed its internal guidelines for drafting and submitting material to the Board of Directors and the Executive Board. In these guidelines, the bank has clarified that matters relating to governance, applicable legislation, and compliance and risk considerations must be included and be pointed out in cover letters.

The FSA finds that the bank's initiatives appear relevant for the purposes of complying with the part of the order that deals with ensuring sufficient attention to the bank's compliance with relevant legislation as regards the decision-making processes of the Board of Directors and the Executive Board.

When it comes to the part of the order that deals with ensuring satisfactory documentation of the decision-making basis, discussions at meetings and decisions made, the bank's response does not contain any specific initiatives as a result of the order. The bank states that the FSA's criticism has increased its attention to the requirements and compliance with them in relation to minutes of meetings of the Board of Directors or Board of Directors committees.

The bank's response does not contain any position on the need for initiatives in forums other than the Board of Directors, Board of Directors committees and the Executive Board. The order has been broadly phrased towards to the bank's governance to ensure sufficient documentation of decision-making processes. The Estonia case showed that there is also a need to ensure sufficient documentation of decision-making processes below Executive Board level.

For example, the follow-up on the whistleblower report should have been carried out below Executive board level, but this was not sufficiently documented. In its decision of 3 May 2018, the FSA wrote the following on the subject:

*According to the material received by the FSA, the investigation was of a general nature. There was thus significant information from the whistleblower that the person responsible for AML activities or others failed to follow up on or did not sufficiently follow up on, and as of today, the Board of Directors and the Executive Board do not have an overview of how the report was handled. The Danish FSA finds, among other things, that it is worthy of criticism that the bank did not follow up on all of the whistleblower's statements about the customers of the Russian intermediaries.*

It is the FSA's assessment that the bank cannot be considered to have fully complied with this order. The Board of Directors and the Executive Board of the bank must account for its initiatives aimed at strengthening governance of decision-making processes and ensuring satisfactory documentation of the decision-making process, discussions at the meetings and decisions made at the meetings.

As with Order no. 4, the FSA will not make its final decision about the bank's compliance with Order no. 5 until adjustments to the governance process have been incorporated into the bank's behaviour.

- 6) *With reference to section 71(1) of the Danish Financial Business Act and section 2 of the Danish Executive Order on Management and Control of Banks etc., the Danish FSA orders the Board of Directors and the Executive Board to assess management at the Estonian branch.*

For one thing, the order reflects this conclusion in the decision of 3 May 2018:

“It took more than one and a half years from the whistleblower report until the branch management was replaced after pressure from the Estonian FSA.. According to information received by the Danish FSA, the choice of the new branch CEO was made without the Board of Directors or the Executive Board taking into consideration his previous activities in relation to the non-resident portfolio and despite the fact that he had worked together with the other

members of the former branch management. This should be viewed in light of the fact that it was standard procedure at the bank that decisions regarding branch CEOs were made without involving the Board of Directors or the full Executive Board.”

In its response, the bank emphasises the recent reorganisation of the Baltic activities with the decision to close down all local activity so that in future, it will serve only subsidiaries of its Nordic customers and international customers in the Baltic countries who have significant Nordic activities. In the Baltic countries, the bank's governance has changed from having a country-based focus to a pan-Baltic basis with a newly established Baltic Management Board and a shared pan-Baltic IT platform.

The bank states that all current members of the newly established Baltic Management Board have been assessed by relevant Group level managers with assistance from Group HR. Furthermore, background checks have been carried out against the internal Estonia investigations conducted under the supervision of Bruun & Hjejle.

With respect to the Estonian branch, the bank emphasises a number of managerial changes, including the departure from the bank of the branch manager who had been involved in the Estonia case.

It is the assessment of the FSA that, with the latest assessments and changes to management and the Estonian branch, the bank has complied with the order.

- 7) *With reference to section 347(1) of the Danish Financial Business Act, the Danish FSA orders the Board of Directors and the Executive Board to ensure that the bank provides adequate information to the Danish FSA.*

For one thing, the order reflects these conclusions in the decision of 3 May 2018:

*GIA's and the consultancy firm's examinations in January to April 2014 showed significant AML problems, but the bank did not inform the Danish FSA of the problems. ... In early 2014, it should have been clear to some Executive Board members and other senior employees that the business procedures were not followed and that the bank's detailed information from 2012 and 2013 to the Danish FSA and the Estonian FSA therefore was misleading. It must also have been clear to them that this was an area of significance to the supervisory authorities.*

*“During 2017, the bank has several times provided information or material about the case to the Danish FSA. As a result of inadequate information being provided to the Danish FSA, the Danish FSA has found it necessary to enquire more than once regarding the same issues in order to receive an adequate reply and to enquire about the bank's knowledge of further cases. This applies, for example, to the statement of 16 October 2017, when the Danish FSA wrote to the Board of Directors and the Executive but received a reply signed by two senior employees. In a few cases, the bank has failed to provide relevant information for which the Danish FSA has asked.”*

In its response, the bank has outlined a new governance model for the interaction with the financial authorities supervising the Group. The bank intends to establish a central unit, which at Group level will coordinate and register all significant interaction with, initially, the FSA. Furthermore, the bank expects the central unit to ensure consistency in quality, transparency and completeness on the part of the bank. The bank expects that the central unit will be implemented before the end of 2018.

As a temporary solution, the bank has prepared a business procedures covering correspondence with the FSA, in which internal procedures as well as roles and responsibilities in connection with the bank's response to requests and enquiries from the Danish FSA addressed to the bank's Executive Board and/or Board of Directors are described. The purpose of the business procedures is, among other things, to



ensure satisfactory information in the bank's correspondence and adequate anchoring in the bank's Executive Board and/or Board of Directors.

The FSA finds that the bank's initiatives appear to be relevant for the purposes of complying with the order. The FSA cannot make a final decision until the new governance model has been operationalised and integrated into the bank's interaction with the FSA.

- 8) *With reference to sections 71(1) and 347(1) of the Danish Financial Business Act, the Danish FSA orders the Board of Directors and the Executive Board to strengthen their governance in order to ensure sufficient involvement in written replies to enquiries from the Danish FSA to the Board of Directors or the Executive Board."*

The bank refers to the business procedures for correspondence with the FSA as mentioned in Order no. 7. The business procedures formalise the process for involving the bank's Executive Board and/or Board of Directors in responses to the FSA. Among other things, it is stated that in future, the bank's full Board of Directors must consider written requests from the FSA addressed to the Board of Directors.

The FSA is of the opinion that through this initiative, the bank complies with the order.

## **2. Complaints procedure**

In accordance with section 372(1) of the Danish Financial Business Act, decisions made by the FSA may be brought before the Danish Company Appeals Board by e-mail to ean@naevneneshus.dk or by letter to Toldboden 2, DK-8800 Viborg, no later than four weeks after the receipt of such decisions. The Appeals Board charges a fee for considering complaints.

Yours faithfully