

# CHAPTER 1: SUMMARY

## 1.1 BACKGROUND TO THE BANKING UNION

The Banking Union consists of a Single Supervisory Mechanism and a Single Resolution Mechanism, which at the outset applies to euro area Member States, with the possibility of non-euro area Member States participating. On 4 November 2014, the European Central Bank (ECB) took over the financial supervision of the largest credit institutions in the euro area, thereby making the Single Supervisory Mechanism a reality. The European resolution authority – the “Single Resolution Board” – was established under the Commission on 1 January 2015 and has begun the preparations for taking over the responsibility for resolving the largest credit institutions by 1 January 2016.

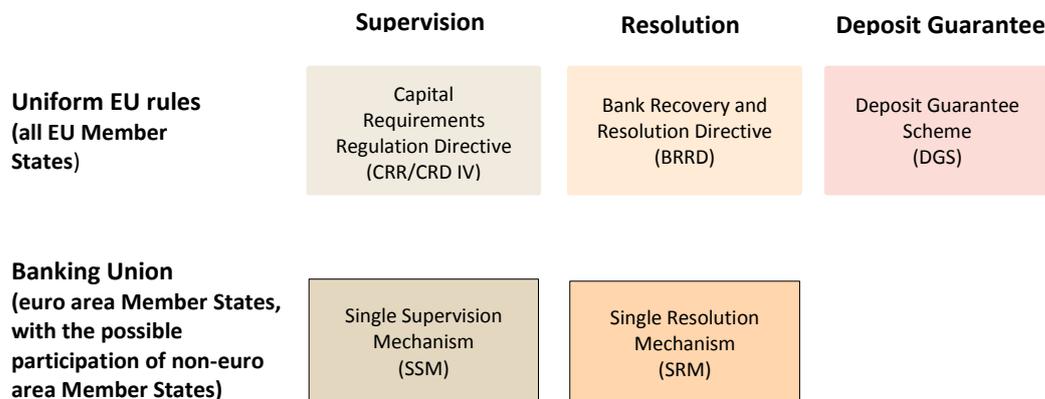
The Banking Union arose out of the financial crisis in a number of euro area Member States, where several Member States were severely affected by problems in their national banks and vice versa. The crisis led to a debate on how to create a more stable financial system thereby avoiding crises in the future. The crisis – not least including the recapitalisation programme for Spain in 2012 – gave rise to discussions relating to the use of the euro area common lending mechanism, the European Stability Mechanism (ESM), to address the challenges in the financial sector in the individual Member States by means of indirect and direct recapitalisations. In these discussions, key stakeholders argued that it was necessary to establish common supervision at EU level before allowing the ESM to provide direct capital injections into failed banks in the euro area.

One of the central goals of the Banking Union is to ensure that the supervision of European banks is implemented in a consistent and efficient manner and is of a high quality. This should help to ensure that problems in the banks are discovered at an earlier stage and are effectively contained in order to prevent contagion to the rest of the financial sector or affecting the national economy. In addition, the Banking Union should help to break the negative interaction between states, banks and the real economy and ensure efficient and uniform crisis management decisions in the EU. Thus, the Banking Union should support financial stability in euro area Member States and the EU as a whole and at the same time contribute to promoting the Internal Market for financial services.

In the wake of the financial crisis, financial regulation and supervision have been comprehensively strengthened throughout the EU to prevent future crises and to support financial stability. This is particularly the case for the new capital requirements for credit institutions (CRR/CRD IV), the uniform EU rules for crisis management of failed institutions (the Bank Recovery and Resolution Directive, BRRD) and the enhanced harmonisation of the national deposit guarantee schemes (DGS). In conjunction with this, The European Banking Authority (EBA) and the European Systemic Risk Board (ESRB) have been established. The work of the EBA and ESRB encompasses all EU Member States.

Figure 1.1 illustrates the uniform EU rules and their interconnection with the Banking Union.

**Figure 1.1: Illustration of uniform EU rules and the rules for the Banking Union**



The CRR/CRD IV, BRRD and DGS constitute the uniform rules (Single Rule Book) for credit institutions in all EU Member States. At the same time, these uniform rules are the foundation of the Banking Union, as the Single Supervisory Mechanism and the Single Resolution Mechanism further develop these rules by establishing a special organisational set-up for applying the Single Rule Book in the participating Member States.

The CRR/CRD IV constitutes the basic regulation for credit institutions in the EU and, inter alia, entails requirements for the amount and quality of the institutions' capital and liquidity as well as requirements for transparency, remuneration, governance and tools for preventing systemic risks. The CRR/CRD IV implements the international Basel III standards in the EU.

The BRRD is based on the principle that the losses of failing institutions as a main rule should be borne by the banks' shareholders and creditors ("bail-in"), not by the taxpayers ("bail-out"). Thus, the BRRD stipulates a minimum requirement for own funds and eligible liabilities which must be available to absorb losses if an institution gets into difficulty. Furthermore, all EU Member States must establish a national sector-financed resolution fund, which must constitute at least 1 percent of covered deposits in the Member State and which can contribute to the financing of crisis management of a failing institution.

## 1.2 THE CONTENT OF THE BANKING UNION

The Banking Union consists of the Single Supervisory Mechanism and the Single Resolution Mechanism. The Banking Union was originally intended to include a common deposit guarantee scheme, but this element has subsequently been dropped. Instead, national deposit guarantee schemes have been further harmonised, and a depositor preference has been implemented whereby deposit guarantee schemes are to a larger degree protected from losses.

The Single Supervisory Mechanism is placed in the ECB, whereas the Single Resolution Board is under the remit of the Commission. For both supervision and resolution, a segregation of tasks has been established between the EU level and the national level.

The ECB supervises the largest credit institutions of the participating Member States, whereas national supervisory authorities as a main rule supervise the other institutions. National supervisory authorities are

responsible for supervising the smaller institutions within the framework set out by the ECB. The ECB is empowered to take over the supervision of one or more of the smaller institutions at any time. For non-euro area Member States there is a mechanism as described in section 1.3.1.

The EU regulation for the Single Supervisory Mechanism (SSM) stipulates the following objectives for the SSM:

- Strengthen the Union, restore financial stability and lay the foundation for financial growth.
- Supervision of credit institutions is conducted in a consistent and effective manner.
- Institutions are subject to top-quality supervision, independent of other non-supervisory considerations.

All supervisory decisions affecting the individual credit institutions supervised by the ECB are prepared by the ECB's Supervisory Board, which is comprised of the directors of the national supervisory authorities of the participating Member States and six representatives from the ECB. To the greatest extent possible, this should prevent overlap between the monetary policy tasks and the supervisory tasks of the ECB, and ensure that all Member States participating in the Banking Union are equally represented in the decision-making process. However, the executive decision making body of the ECB, the Governing Council, where only the governors of the national central banks of the euro area Member States are represented, has the right to object to any decision by the Supervisory Board. In this event, it will be up to the Supervisory Board to make a new decision, after which the Governing Council will once again have the right to object.

The ECB is also competent to address systemic financial risks, i.e. risks which can put pressure on all or significant segments of the financial system and, thus, the national economies. The ECB can address these risks by applying the macroprudential tools stipulated in the CRR/CRD IV, which are powers to the authorities aimed at preventing the build-up of systemic risks in the financial sector and mitigating the consequences deriving hereof. The macroprudential tools are not applied to individual institutions but to the entire sector or a group of institutions. Macroprudential tools include for instance the countercyclical buffer and SIFI capital requirements.

The ECB has the option of rising – but not lowering – the national macroprudential requirements within the EU regulatory framework. The intention behind this is to counter the risk of participating Member States relaxing their preventive macroprudential efforts because supervisory responsibility is transferred from national to European level. As a consequence, the ECB can stipulate a stricter financial regime to counter systemic financial risks than what is nationally preferred by the individual country based on its national priorities. At the same time, it must be assumed that this will entail a more coherent and consistent application of the macroprudential tools across countries, thus benefiting financial stability in Europe.

In addition to the Single Supervisory Mechanism, the Banking Union consists of the Single Resolution Mechanism which will be operational from 1 January 2016. Member States participating in the Single Supervisory Mechanism will automatically participate in the Single Resolution Mechanism as well.

The primary objectives of the Single Resolution Mechanism (SRM) as stated in the regulation are:

- Break the negative interaction between states, banks and the real economy.
- Enhance the integration of the resolution rules for credit institutions to thereby restoring financial stability.
- Ensure effective, uniform implementation of crisis management decisions in the Union.

Within the Banking Union, national sector-financed resolution funds will gradually be merged into a single sector-financed fund towards 2024. This Single Resolution Fund must constitute at least 1 percent of the covered deposits in the credit institutions of all participating Member States. When fully developed in 2024, the fund will exceed DKK 400 billion.

With the establishment of the Single Resolution Mechanism the responsibility for crisis management of the largest credit institutions is transferred from the national resolution authority to the Single Resolution Board. This means that if a large institution becomes distressed, the Single Resolution Board will decide how to deal with the institution, although the national resolution authority will be involved in the decision-making process. As a general rule, the other institutions will continue to be resolved by the national resolution authorities. The Single Resolution Board will become involved in the handling of a smaller institution if the national authority wishes to use resources from the Single Resolution Fund.

In the Single Resolution Board most decisions affecting specific institutions will be made by an executive session, with the participation of the national resolution authorities of the affected Member States, together with five permanent members of the Single Resolution Board. Decisions in cases requesting a substantial infusion from the Single Resolution Fund (e.g. recapitalisation of more than EUR 5 billion) or decisions of a more general nature are to be taken in the plenary session, in which the national resolution authorities of all participating Member States take part. The Commission can amend decisions taken by the Single Resolution Board, and the Council can also become involved in certain instances.

The main principle in the EU rules for dealing with failing credit institutions is that loss and recapitalisation, if necessary, are as a main rule covered first by write-down of shareholders and subsequently write-down and/or conversion of creditors, i.e. bail-in. This applies both within and outside the Banking Union and follows the same approach applied in Denmark for several years through Bank Package 3. Specifically, bail-in of at least 8 percent of the institution's liabilities is to be implemented before the Single Resolution Fund can be used to absorb losses and recapitalisation. The intention behind this is to ensure that the institution's owners and creditors fund the resolution themselves – not the taxpayers. The centralisation of the crisis management decision-making processes in the Banking Union can make it more credible at European level that the new tools for crisis management of credit institutions, including in particular bail-in, will be used as intended.

In special instances, for instance if an SIFI – i.e. an institution that is considered to be so large that it has an effect on national financial stability – becomes distressed, there may be a need to use the Single Resolution Fund in the event that the mandatory bail-in of at least 8 percent of the liabilities is not sufficient for recapitalising the institution and the Single Resolution Board assesses that additional bail-in is not appropriate.

If the Single Resolution Fund cannot sufficiently contribute to the handling of a specific institution, and the government in the institution's home country is not in a position to provide a national loan, it will be possible, as a last resort, to provide a loan for the fund from a common public bridge-financing mechanism (a permanent public "backstop"). This must be implemented no later than 2024. The more detailed terms of the mechanism have yet to be determined, including the terms for public funding provided by the participating Member States. In the transitional period, during which the fund is being built up, the euro area stability mechanism (ESM) will be used for this purpose in euro area Member States. A parallel solution based on other EU instruments has been established for participating non-euro area Member States.

In addition to supporting financial stability, the Banking Union will also be able to strengthen the Internal Market. Thus, it is expected that the ECB and the Single Resolution Board will develop a uniform practice for supervision and crisis management within the Banking Union thereby ensuring equal treatment of institutions from different Member States.

The Banking Union is a new system which needs to be developed. Uniformity in supervisory and resolution practices needs to be established across Member States and institutions, yet due consideration must be given to the wide variety of types, business models and sizes of credit institutions in the EU banking sector.

It is assumed that the Single Resolution Board's independence from national governments will support that bail-in will become the fundamental tool in all participating Member States, including when dealing with large institutions.

With the constructions and the rules on which the Single Supervisory Mechanism and the Single Resolution Mechanism are based there is a firm foundation for ensuring that both the supervision and the management of failing banks will be of high quality. In terms of supervision, this was supported by the "health check" of euro area banks carried out by the ECB in 2014, before the beginning of the Single Supervisory Mechanism.

### 1.3 PARTICIPATION IN THE BANKING UNION

#### 1.3.1 Participation for non-euro area Member States

At present, the Banking Union comprises the 19 euro area Member States. EU Member States which join the euro area will at the same time enter the Banking Union.

It is possible for non-euro area Member States, including Denmark, to participate in the Banking Union by entering into a "close cooperation" with the ECB (cf. Chapter 5). This will happen after a decision taken by the ECB upon request from the non-euro area Member State in question. For instance, if Denmark applies to participate, the ECB will make a decision based, inter alia, on an assessment of whether Denmark will ensure by law that the national authorities will follow the instructions issued by the ECB. In addition, the ECB will assess Denmark's credit institutions to ensure that they are adequately capitalised. As part of establishing a close collaboration with the ECB, Denmark will also automatically be subject to the Single Resolution Mechanism.

For participating non-euro area Member States, the ECB's supervision will be implemented by means of instructions issued to the national supervisory authorities responsible for the following implementation. On the other hand, the European Single Resolution Board will be responsible for the crisis management of the Danish credit institutions.

Non-euro area Member States will participate in the ECB Supervisory Board and in the decision-making bodies of the Single Resolution Board. It is not possible for non-euro area Member States to participate in the ECB Governing Council, which is the executive decision-making body of the ECB and thus also of the Single Supervisory Mechanism. In return, it is possible for non-euro area Member States – by contrast to euro area Member States – to leave the Banking Union and, in certain circumstances, they can choose not to follow a supervisory decisions which is taken by the ECB (cf. Chapter 5). The latter option is possible in the event that the Governing Council objects to a recommendation submitted by the Supervisory Board. In this situation, the Supervisory Board must draft a new decision which Denmark could, in this event, choose not to follow. In this case, it would subsequently be up to the ECB to decide whether this should result in the

termination of the close cooperation with Denmark. Denmark could also choose not to follow an instructions issued by the ECB, which follows a recommendation of the Supervisory Board, but this would mean that Denmark must leave the Banking Union.

Sweden and the United Kingdom are particularly interesting to Denmark, as the foreign activities of Danish banks today are primarily aimed at these two countries (cf. Chapter 6). Sweden has stated that it is not planning to participate in the Banking Union at present, while the United Kingdom has announced that it does not wish to participate in the Banking Union, not even at a later stage. It is possible, however, that the supervisory practices which will be developed within the Banking Union will affect the practices of the Member States which are not participating in the Banking Union. This is particularly the case if these practices will end up influencing future EU regulation.

The ECB has yet to receive a formal application concerning close collaboration from a non-euro area Member State. Romania, Bulgaria and Croatia have expressed positive interest in taking part in the Banking Union. As far as it is known, no position has been taken in Poland or Hungary. In February 2015, the Czech authorities published a report recommending a “wait-and-see approach”. At the same time, it is recommended that this conclusion would be reassessed within twelve months.

### **1.3.2 Danish participation in the Banking Union**

Danish participation in the Banking Union will affect a number of factors, which are singled out below. These factors are dealt with in more detail in Chapters 8–16.

#### ***Ensuring Danish interests in the EU***

Full participation in the Fiscal Compact and the Euro Plus Pact gives Denmark contributory influence on decisions of importance to the European and the Danish economy. Danish participation in the Banking Union could also enhance the possibilities to ensure Danish interests in the EU (cf. Chapter 8). This is particularly the case in relation to legislative developments in the financial services area, including the specific standards and the practice which will apply to supervision and resolution. Similarly, by participating in the Banking Union, Denmark will be in a better position when it comes to ensuring specific Danish interests in terms of any possible treaty amendments in the economic and financial services area.

Participating in the Banking Union will furthermore make it clear to the other Member States and the EU institutions that Denmark wishes to contribute constructively to the further development of the EU within the framework of the Danish opt-outs. Conversely, a no to Danish participation in the Banking Union will further distance Denmark from full participation in the EU collaboration. Thus, ensuring Danish interests could become more difficult.

#### ***Participation in the Single Supervisory Mechanism***

It is a key consideration when it comes to Denmark’s possible participation in the Banking Union whether participation will improve the supervision of credit institutions covered by the mechanism, including how fast and efficient supervisory decisions can be made. At present, Denmark is deemed to a financial supervision which is well-functioning and of a high-quality. With the construction and the rules on which the Single Supervisory Mechanism are based there is a firm foundation for ensuring that the new supervision will also be of high quality (cf. Chapter 9).

It will presumably be easier for the ECB to attract relevant expertise with specialised knowledge within certain specialised areas, e.g. complex models for market and operational risks. However, in this respect it is worth noting that the Danish Financial Supervisory Authority (Danish FSA) currently has the possibility – to

the extent that the skills are not already available – of obtaining expert assistance, including requiring the institutions themselves to pay for the consultancy services needed.

In addition, the ECB is expected to benefit from a broader basis for comparison, as the ECB will have to supervise more and bigger institutions. Participation in the Banking Union will also entail different views on Danish institutions compared to a situation where the supervision were solely carried out by the Danish FSA, and these different views can help to challenge a potential established national consensus.

Conversely, the efficiency of ECB's supervision could be hampered by the insertion of an additional layer into the decision-making process. An expected consequence of "different views" on Danish institutions could therefore be that the Danish FSA must use resources on replying to queries from the ECB, which does not in itself contribute to improving the supervision of the institutions. Furthermore, this extra layer could be important when it comes to withdrawal of authorisation to operate as a credit institution, as such a decision would have to be taken relatively quickly. However, the procedures in the ECB are expected to be organised in a way that, in practice, quick decisions can be made whenever necessary, as is the case with other EU processes.

It is nevertheless still too early to draw any unequivocal conclusions about the quality of the common supervision and the specific supervisory practices of the ECB. Similarly, there is no indications that the ratings of Danish credit institutions will be affected by whether they are subject to supervision by the ECB or not. Against this background, it is not the expectation that a Danish decision not to take part in the Banking Union would in itself result in a market pressure for increased capitalisation in the Danish institutions. This should also be seen in the light of the fact that the Danish institutions are among the best capitalised in the EU today.

Joining the Banking Union would mean that some parts of the existing supervisory practice as well as a few rules in Denmark would be difficult to maintain. This includes inter alia the requirement to publish institutions' individual solvency needs and inspection reports of the Danish FSA, as well as the use of supervisory diamonds, all of which were implemented in Denmark as a response to the financial crisis.

Besides supervising individual institutions, it will be possible for the ECB to require a strengthening of the specific macroprudential tools which national authorities must have at their disposal pursuant to CRR/CRD IV (cf. Chapter 10).

The Governing Council of the ECB has greater competence in the macroprudential area than in the rest of the supervisory area. As a general rule, the Supervisory Board is responsible for decisions in relation to applying macroprudential tools in Denmark and the other participating Member States, whereas the Governing Council has the right to object to the decision. However, the Governing Council has the right to amend a draft decision from the Supervisory Board, and to bypass the Supervisory Board and thereby make decisions on its own initiative. In every instance, however, the ECB will have to act via the Danish authorities and not directly vis-à-vis the Danish credit institutions. As the right of non-euro area Member States not to follow a decision from the ECB, cf. the above, is contingent on the decision being dealt with by the Supervisory Board, the "protection" which applies to decisions concerning individual institution does not correspondingly apply to decisions concerning the initiation of macroprudential tools.

The extent to which these macroprudential powers will be exercised is up for the ECB to decide, and the extent to which the Governing Council will bypass the Supervisory Board when applying the macroprudential

tools is unclear. It is likely that the ECB will follow up on a recommendation from the national systemic risk council to activate a CRR/CRD IV tool if the national authority chooses not to follow such a recommendation. This involves, for instance, the countercyclical capital buffer and the capital requirements imposed on SIFIs. It will not be possible for the ECB to follow up on a recommendation from the national authority concerning other macroprudential initiatives, e.g. legislative amendments. In case of possible Danish participation in the Banking Union, due consideration must be given to whether this should lead to an adjustment of the statutory framework for the Systemic Risk Council (cf. Chapter 10).

If Denmark participates in the Banking Union, the Danish FSA will be instructed to implement the decisions made by the ECB in relation to Danish institutions, and the Danish FSA will therefore also be responsible for these decisions. If the Danish FSA is required to pay compensation based on an order which the ECB has instructed the Danish FSA to issue, the Danish FSA can apply for compensation from the ECB.

Participation in the Banking Union will involve higher expenditure for supervision, which will be covered by the financial sector (cf. Chapter 3).

### ***Participation in the Single Resolution Mechanism***

With the establishment of the Single Resolution Mechanism, which will be fully operational from 2016, the responsibility for the crisis management of the largest institutions will be moved from national to the EU level. This will probably mean that more uniform and coherent crisis management decisions will be taken at European level, and that bail-in will become the key tool, including when dealing with the largest institutions. This is one of the purposes of establishing the Single Resolution Mechanism.

Denmark has – as the first Member State in the EU – used bail-in to resolve small and medium sized credit institutions during the financial crisis but has no experience in dealing with failing SIFIs.

For banks, there will hardly be any significant difference between the practice used by the Danish resolution authority and the Single Resolution Board. There can be differences when it comes to mortgage credit institutions (cf. the section on the Danish mortgage credit system below). Differences can also arise for institutions which, in a European context, are considered small or medium sized, but which nationally are, or are close to being, defined as SIFIs. There may be differences in the way these institutions are treated at national and European levels respectively, including whether the Single Resolution Fund is used (cf. Chapter 11).

The Single Resolution Board will presumably amass greater expertise and gain more experience than the Danish resolution authority when it comes to resolution decisions and the drafting of resolution plans, as the Single Resolution Board will handle a far greater number of institutions. In addition, there will be different views on crisis management decisions as both the national resolution authority and the Single Resolution Board will take part in the resolution. These factors can help to enhance the quality of the resolution decisions taken at European level.

The internal decision-making process of the Single Resolution Board could entail that action cannot be taken as quickly at European level as at national level. Time can be a critical factor when it comes to resolution decisions, as it can reduce uncertainty and inconvenience to the institution's customers etc. if the institution is resolved over a weekend whereby the institution's customers can once again access their accounts etc. on Monday morning. Here, too, it is, however, assumed that procedures will be organised in a way to ensure that, in practice, decisions can be made with sufficient speed when necessary.

As the Single Resolution Board will not be fully operational until the beginning of 2016, there are obviously at this point still no concrete experiences when it comes to resolution of institutions at EU level.

### ***Resolution funds, etc.***

Pursuant to the BRRD, all EU Member States must establish a national sector-financed resolution fund of 1 percent of the covered deposits in the institutions of that Member State, which in the case of Denmark will constitute around DKK 8–9 billion. In the Banking Union, the funds of the participating Member States will gradually be merged into a Single Resolution Fund towards 2024. This Single Resolution Fund must constitute at least 1 percent of the covered deposits in the credit institutions of all participating Member States. The contributions from the credit institutions to the Single Resolution Fund will depend on their size and risk profile. If Denmark participates in the Banking Union, the total contribution by the Danish institutions to the initial build-up of the Single Resolution Fund will presumably not deviate significantly from the institutions' contributions to the Danish resolution fund in the event that Denmark does not participate (cf. Chapter 12). Whether the total contribution of the Danish institutions will be larger or smaller will depend on their size and risk profile compared to institutions from the other participating Member States.

There would need to be very significant losses before national resolution authorities or the Single Resolution Board would be able to use the resolution funds to absorb losses and to recapitalisation, as the rules for absorbing loss and recapitalisation of failed institutions require bail-in of at least 8 percent of the liabilities before resolution funds can be used for these purposes.

This means that if a Danish SIFI becomes distressed, the Danish resolution fund can only be used to absorb losses or to recapitalise in the event of very large losses. Such large losses are deemed highly unlikely (cf. Chapter 12). Should a situation nevertheless arise involving large losses in an institution, the Danish resolution fund can contribute with up to 5 percent of the liabilities. If a contribution of this size is needed, the resolution fund would be insufficient for most Danish SIFIs. Therefore, in this situation, a loan or a guarantee from the Danish state to the Danish resolution fund could be necessary.

The Single Resolution Fund will be far bigger than the national funds and, accordingly, under normal circumstances, the Single Resolution Fund will be able to absorb losses of and recapitalise several SIFIs in the Banking Union with up to 5 percent of the liabilities, in the event that these institutions suffer large losses. However, the Single Resolution Fund will have to cover the crisis management of failed institutions in all participating Member States. Under normal circumstances, the Fund would be able to absorb losses of several SIFIs simultaneously. There are, however, a few major SIFIs in the participating Member States which could empty the fund single-handed if they were to become severely distressed. Especially in an extraordinary situation where large losses are incurred by Danish SIFIs, access to a larger fund could benefit financial stability in Denmark by enabling a higher degree of loss absorption and create certainty for the continuation of critical functions. It is, however, deemed highly unlikely that such a situation would arise.

The “health check” of the credit institutions in Europe before the commencement of the Single Supervisory Mechanism showed that the Danish SIFIs are currently among the best capitalised institutions and with the fewest expected write-downs going forward. At the same time, the “health check” resulted in a substantial increase in the capital of the institutions in the other participating Member States and, furthermore, resulted in demands that the poorest-performing banks in the test should further boost their capital. In addition, the supervision of these banks is generally expected to be tighter, which could mitigate some of the risk involved with the riskier banks.

As the recent financial crisis demonstrated, it is not only problems in the financial sector which can have a fiscal impact. Financial problems in a given country can also affect the country's financial sector. Some Member States participating in the Banking Union continue to face significant economic challenges, especially in relation to the public finances. Some Member States' banks also have a relatively large share of non-performing loans, which can entail further write-downs.

The above circumstances entail that, in the short to medium-term, SIFIs in the rest of the euro area are more likely to come in a situation where they need to draw on the Single Resolution Fund than SIFIs in Denmark. If resources are withdrawn from the Fund, Danish institutions would have to contribute to replenishing the Fund in the same way as other institutions in the Banking Union (cf. Chapter 12).

### ***Deeper Internal Market***

A more uniform practice for supervision and resolution within the Banking Union can strengthen the competition in the Internal Market in the long term (cf. Chapter 14). This will especially be the case if this practice ends up influencing future EU regulations in the area.

The magnitude of this effect should, however, not be overestimated, as most of the regulation to which credit institutions in the EU are subject is determined at EU level through directives and regulations. The rules within and outside the Banking Union will therefore, as a main rule, be uniform. In addition, banks from other EU Member States can today grant loans and provide banking services to Danish companies and consumers from branches both in Denmark and in other Member States without being subject to Danish supervision or Danish financial legislation. This applies correspondingly to the activities of Danish institutions in relation to customers in other EU Member States. Finally, the foreign activities of Danish banks today are primarily aimed at Sweden and the United Kingdom, which could, however, obviously change in the long term.

### ***Danish influence in relation to supervisory and resolution practice***

A fundamental condition when participating in the Banking Union is that the development of supervisory practices and decisions relating to supervision as well as crisis management of the larger national credit institutions will take place at European level and not at the national level. However, Denmark, like other participating Member States, will still need to address national interests in relation to both supervision and resolution.

The Danish FSA will have a seat on the Supervisory Board. This means that it would be possible to influence the supervisory practices of the ECB and the specific supervisory decisions relating to both Danish and foreign institutions. The Governing Council, in which Denmark does not participate, however, has the right to object to any decision proposed by the Supervisory Board.

Denmark will exert influence on the Single Resolution Board through the Danish resolution authority (Danish RA). Thus, the Danish RA will be represented in the executive session when decisions concerning the largest Danish institutions are being discussed. However, in the event of disagreement, the five permanent members of the Single Resolution Board will ultimately be able to bypass the national resolution authorities and make the final decision. Similarly, the Commission will also be able to amend most of the decisions proposed by the Single Resolution Board, in certain instances following approval of the Council. This is the case for all other participating Member States, both euro area and non-euro area Member States. The Danish RA will also be represented in the plenary session where general issues as well as specific cases – when significant withdrawals from the Single Resolution Fund are proposed (above EUR 5 billion for recapitalisation) – will be discussed and decided.

Overall, in the event of Danish participation in the Banking Union, a substantial part of the supervisory and crisis management decisions, particularly concerning larger institutions, will no longer be a national matter, but will be decided by EU authorities. This is a fundamental condition when participating. In turn, when participating Denmark will be able to exert influence on practices and decisions relating to supervision with and – in certain instances – crisis management of the largest institutions in the other participating Member States.

### ***The Danish mortgage credit system***

The business model of the Danish mortgage credit institutions, which in mid-2014 were responsible for over 60 percent of the domestic loans granted to companies and households, does not exist in an equivalent manner in other EU Member States. For instance, mortgage credit institutions are not permitted to accept deposits, and their lending is largely based on security in real estate within stipulated limits. The institutions are furthermore subject to strictly defined limits when it comes to the amount of market risk they may assume, and therefore, all together, they typically represent a low risk. Historically, it has been challenging to make the European rules – which are typically aimed at more traditional banking models – fit the business model of the mortgage credit institutions. In this light, it is of central importance how the Danish mortgage credit system is expected to be treated within the Banking Union.

In addition to the common European rules, mortgage credit institutions are subject to national Danish rules (cf. Chapter 15). It is the assessment that it will generally be possible to uphold the Danish mortgage credit system in the event that Denmark participates in the Banking Union. The ECB has indicated that there is a need for a technical dialogue with the Danish authorities in order to take a closer look at whether the Danish mortgage credit legislation is compatible with the CRR prior to Denmark's possible participation in the Banking Union. It is the assessment of the Danish authorities that the existing national mortgage credit legislation is consistent with the CRR, however it cannot be ruled out that there may be a need to adjust the Danish mortgage credit legislation based on the ECB's review.

There are areas in the CRR/CRD IV where there is discretion to the supervisory authority in deciding how to apply a given provision. In the Banking Union, these options, e.g. in relation to diversification requirements in the liquidity buffer and wider use of guarantees as collateral for covered bonds, would have to be exercised by the ECB via instructions to the Danish FSA. In the event of Danish participation, it will be of central importance for the Danish mortgage credit system that the ECB chooses a practice in these areas which does not significantly deviate from the practice chosen by the Danish FSA.

A key element of the BRRD and the SRM regulation is that credit institutions must observe a minimum requirement of eligible liabilities (MREL). This requirement – which is individually determined for each institution by the relevant resolution authority – is intended to ensure that bail-in can be performed to the necessary extent if an institution fails.

However, mortgage credit institutions like the ones in Denmark are covered by a special exemption from having to meet a minimum requirement for eligible liabilities set by the resolution authority, if a failed mortgage credit institution can be handled without the use of bail-in. In the Danish legislation, which transposes the BRRD into Danish law, it is assumed that this is the case. Thus, a distressed mortgage credit institution will have to be handled using other tools, such as divestment of activities, continuation of the institution's most significant activities in a bridge bank with a view to re-sale or by the use of the resolution model of the Mortgage Credit Act, which means that the institution will gradually be wound up concurrent with the repayment of the institution's loans.

If Denmark participates in the Banking Union, the SRM regulation will take precedence over the Danish legislation implementing BRRD. Therefore, a continued exemption of the mortgage credit institutions from the MREL requirement and from being resolved by means of bail-in will therefore be contingent on the Single Resolution Board taking the same approach as specified in the Danish legislation, i.e. that Danish mortgage credit institutions can be resolved without using bail-in. If this is not the case, the mortgage credit institutions will be required to meet a MREL requirement set by the Single Resolution Board. Such a requirement can entail costs and refinancing risk for the mortgage credit institutions, if it assumes a sizeable amount. In this situation, failing mortgage credit institutions could also be resolved by means of bail-in.

The generally increased EU harmonisation in the financial services area can exert some pressure on the Danish mortgage credit system, regardless of whether Denmark participates in the Banking Union or not. Thus, it is declared priorities of both the EBA and the ECB to further harmonise the supervisory practices within the EU and the Banking Union, respectively. Furthermore the ECB also wishes to reduce the differences resulting from the national discretions in the CRR/CRD IV. Whether the interests of the Danish mortgage credit system are best managed within or outside the Banking Union will depend on the specific issues and dynamics within the EU and the Banking Union going forward.

A sizeable part of the framework for EU regulation in the financial services area is based on rules laid down in global financial forums, including the Basel Committee, where Denmark is not represented, but where the Commission, a number of EU Member States, and the ECB participate. Experience shows that the rules emanating from global forums do not take account of the special characteristics of the Danish mortgage credit system. These rules form the basis for the EU regulation, which therefore runs the risks of not considering the interests of the Danish mortgage credit system either.

If Denmark participates in the Banking Union, there will in principle be an additional possibility through the ECB – compared to today – to influence the international discussions and how the ECB applies the discretions in the EU regulation in force at any given time. Some of these discretions will be of particular importance to the Danish mortgage credit system, cf. above. To the extent that such choices made within the Banking Union will affect the design of future EU legislation, Danish participation could strengthen Denmark's ability to ensure Danish interests in the EU when it comes to the mortgage credit system.

By contrast, inside the Banking Union it can be more difficult to obtain support to design future EU regulations in a way which accommodates the unique business model of the Danish mortgage credit institutions if other Member States in the Banking Union finds that Denmark's wishes go against transverse considerations within the Union. Outside of the Banking Union, it will be up to Denmark to manage the options provided for by EU law, to develop a supervisory practice and to specify supplementary national rules, including in the area of mortgage credit institutions.

This speaks in favour of achieving an overall understanding of the unique business model of the Danish mortgage credit system, and for clarifying with the ECB and the Single Resolution Board how Denmark's mortgage credit institutions will be treated before taking a possible decision on Danish participation.

#### ***Framework for parliamentary involvement***

The framework for the involvement of the Danish Parliament (Folketinget) in relation to supervision and resolution of Danish credit institutions will not be changed by participation in the Banking Union (cf. Chapter 13). It will be possible for the parliament to request a consultation with the Government concerning

supervision and resolution of Danish institutions. The scope of the information to which the relevant minister will have access, and thus the scope of information that can be disclosed to the Danish Parliament, may, however, be smaller within the Banking Union. This could for example be due to the fact that crisis management decisions relating to Danish SIFIs no longer requires the approval of the minister as these decisions will be taken by the Single Resolution Board, possibly with the involvement of the Commission and the Council. In practice, control in this area is therefore to a large extent expected to happen at European level.

Furthermore, the Danish Parliament will still have to approve the Danish FSA's annual expenses, whereas the Danish Parliament will not have any influence on the [appropriation of the](#) ECB expenses and consumption of resources, as this is set by the ECB itself. The same applies to the Single Resolution Board.

At EU level, political involvement will take place through the European Parliament and the Council (cf. Chapter 13). For instance, the ECB must present an annual report on the performance of its tasks to the European Parliament, the Council, the Commission and the Euro Group, just as the Single Resolution Board must present an annual report to the European Parliament, the Council, the Commission and European Court of Auditors. In addition, the chair of the ECB Supervisory Board and the chair of the Single Resolution Board are required to take part in hearings, respond to questions and conduct confidential discussions with the European Parliament, just as the ECB is required to contribute to any review committees appointed by the European Parliament. The ECB must furthermore submit to the relevant committee of the European Parliament minutes of the discussions of the Supervisory Board as well as an overview of the decisions being taken. If the Governing Council objects to a recommendation from the Supervisory Board, the chair of the relevant committee of the European Parliament must be informed of the reason for the objection.

Finally, The European Parliament shall approve ECB's recommended candidate for the chair and vice-chair of the Supervisory Board, just as the Council must adopt the appointments of these individuals. It is also possible for the national parliaments of the participating Member States to ask questions etc., and be kept informed by the EU authorities.

### ***Greenland and the Faroe Islands***

Danish participation in the Banking Union will also have an impact on Greenland and the Faroe Islands, who are not members of the EU and accordingly cannot participate in the Banking Union if Denmark decides to join.

The ECB has stated that, as Greenland and the Faroe Islands are not members of the EU, credit institutions in these areas are excluded from the Single Supervisory Mechanism and thus also from the Single Resolution Mechanism.

If Denmark participates in the Banking Union, supervision of the credit institutions in Greenland and the Faroe Islands will continue as today. It will be possible to maintain the resolution regime in effect in Greenland and the Faroe Islands, but there will not be access to the Danish resolution fund, which – except for contributions from institutions from Greenland and Faroe Islands – will be merged with the Single Resolution Fund.

A separate resolution fund for Greenland and the Faroe Islands will thus be relatively limited in size (cf. Chapter 16) and therefore, a possible solution is to establish a resolution fund for the institutions of Greenland and the Faroe Islands which constitutes more than 1 percent of the covered deposits in

Greenland and the Faroe Islands. An alternative solution could be to set higher SIFI-capital requirements than planned for the future SIFIs in Greenland and the Faroe Islands in order to further prevent the institutions from failing.

In the event that Denmark participates in the Banking Union, the above factors need to be discussed in more detail with Greenland and the Faroe Islands.

In June 2014, a task force with the participation of Greenland and the Faroe Islands was appointed concerning possible Danish participation in the Banking Union in the EU. The task force was appointed in order to assess the consequences and possibilities for Greenland and the Faroe Islands in the event that Denmark decides to participate in the Banking Union. The task force has not yet finished its work. Therefore, the conclusions of this report concerning the consequences and possibilities for Greenland and the Faroe Islands in the event of Danish participation are provisional.

#### 1.4 OVERALL ASSESSMENT

Full participation in the Fiscal Compact and the Euro Plus Pact gives Denmark influence on decisions of importance to the European and the Danish economy. Danish participation in the Banking Union could also enhance the possibilities to ensure Danish interests in the EU. This is particularly the case in relation to legislative developments in the financial services area.

In addition, participating in the Banking Union could give access to a larger sector-financed resolution fund. Especially in an extraordinary situation where large losses are incurred by Danish SIFIs, access to a larger fund could benefit financial stability in Denmark. Such a situation is, however, deemed highly unlikely and less likely than SIFIs in the euro area getting into this situation. Certain Member States in the Banking Union thus continue to face significant economic challenges, especially in relation to the public finances, and banks with a relatively large share of non-performing loans. However, the “health check” of the institutions in Europe has resulted in a substantial increase in the capital of the institutions in the participating Member States, and also resulted in demands that the poorest-performing banks in the test should further boost their capital. In addition, the supervision of these banks is generally expected to be tighter.

An advantage of Danish participation could also be that the more uniform practice of supervision and resolution within the Banking Union can strengthen the competition in the Internal Market in the long term. This will especially be the case if this practice will influence future EU regulations in the area. Such an impact on the Internal Market should, however, not be overestimated.

At present, Denmark is deemed to have a financial supervision which is well-functioning. With the construction and rules on which the Single Supervisory Mechanism is based there is a firm foundation for ensuring that the ECB’s supervision will also be of high quality, inter alia because the ECB will have a broad basis for comparison by virtue of its supervision of the largest institutions in the EU. It is, however, still too early to draw any unequivocal conclusions about the quality of the common supervision and the specific supervisory practice of the ECB. Similarly, it is still too early to assess whether there will be differences in the choice of specific crisis management tools and the use of the resolution fund at national and European level, as the Single Resolution Board will not be fully operational until 2016.

A fundamental condition when participating in the Banking Union is that the development of supervisory practice and decisions relating to supervision as well as crisis management of especially the largest Danish credit institutions will take place at European level. Consequently, joining the Banking Union will make it difficult to maintain parts of the existing supervisory practice as well as a few rules which were implemented in Denmark as a response to the financial crisis, including the Danish FSA's supervisory diamonds and the requirement to publish banks' individual solvency needs and inspection reports of the Danish FSA.

Participation would mean that the ECB will have the right to require a strengthening of the use of macroprudential tools which national authorities have at their disposal pursuant to the CRR/CRD IV. Furthermore, by contrast to supervisory decisions, the Governing Council can bypass the Supervisory Board on such decisions. It is up to the ECB to determine the extent to which it chooses to exercise its powers in the macroprudential area, and it is unclear to which extent the Governing Council will bypass the Supervisory Board when applying the macroprudential tools. It is likely, however, that the ECB will follow up on recommendations from national systemic risk councils to activate a CRR/CRD IV tool if the national authority chooses not to follow such a recommendation.

Finally, Danish participation will have implications for Greenland and the Faroe Islands, who are not members of the EU. Greenland and the Faroe Islands will not be covered by the Banking Union, and the banks of Greenland and the Faroe Islands will therefore not have access to a resolution fund together with the Danish institutions once the Danish resolution fund merges with the Single Resolution Fund. If Denmark participates in the Banking Union, supervision of the credit institutions of Greenland and the Faroe Islands will be able to continue as today.

It is the assessment that altogether much speaks in favour of participation in the Banking Union as being in the interest of Denmark. At the same time, additional clarification in some areas would be desirable.

In some areas clarifications will take place as experiences with the Banking Union are gained. This applies for instance to questions in relation to the practice and decision-making process of the ECB and the Single Resolution Board. In addition, greater clarity could be gained in relation to the handling of the economic challenges, especially in relation to the public finances, of certain European countries, which can affect the health of the banks in the countries concerned.

In other areas, clarity should be obtained through further discussions with the ECB, the Single Resolution Board and the Commission. This is particularly the case for the treatment of the Danish mortgage credit system and the Governing Council's right to bypass the Supervisory Board when it comes to decisions on macroprudential tools in Denmark. The needed clarifications concerning the treatment of the Danish mortgage credit system, macroprudential decisions etc. within the Banking Union should be provided before deciding on Danish participation in the Banking Union.

**This document is an English translation of the original Danish text. In the event of discrepancies between the original Danish text and the English translation, the Danish text shall prevail.**