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Danish banks show robustness in new European stress test

A new EU-wide stress test shows that the four largest Danish banks will maintain their capital buffers, even in the event of negative economic developments. Even under stress, Danske Bank, Nykredit, Jyske Bank and Sydbank will maintain Common Equity Tier 1 capital ratios of between 12.6-14.2 per cent at end-2018. The result of the stress test has not given rise to supervisory reactions. However, the Danish FSA emphasises that banks must continue their focus on building up capital.

"Overall, this is a good result, from a Danish point of view. However, even though the largest Danish banks are performing well, continuous focus on building up capital is still crucial in light of the increasing capital requirements," said Deputy Director General, Kristian Vie Madsen.

The European Banking Authority (EBA) has just published the results of the EU-wide stress test 2016. The stress test is intended to evaluate the resilience of the European banking sector to an unfavourable economic development. The stress test is based on a common European stress scenario, as well as a common methodology for calculating associated consequences. The stress test also provides comparable results between participating institutions, and it contributes to creating transparency about the exposures and risks of the European banking sector.

For Denmark, the stress scenario reflects a severe economic downturn, with negative GDP growth, considerable decreases in housing and commercial property prices, as well as increasing unemployment. The scenario is significantly more severe for Denmark than in previous European stress tests and it is severe in an EU context, see table 1.

Table 1: Scenario table for DK, EU and the Eurozone

Scenario variables	EBA EU-wide stress test 2016					
	DK		EU		Eurozone	
	over 2 years	over 3 years	over 2 years	over 3 years	over 2 years	over 3 years
Accumulated growth in per cent						
Real GDP	-4.1	-2.3	-2.5	-1.8	-2.3	-1.7
Residential property prices	-14.5	-14.5	-10.4	-10.9	-9.4	-9.3
Commercial property prices	-16.5	-22.0	-11.9	-15.0	-9.9	-11.3
Per cent / percentage points						
Unemployment - level end of period	9.7	10.8	10.8	11.6	11.7	12.4
Unemployment - change compared w/ 2015	3.5	4.6	1.3	2.1	0.7	1.4
10Y government bond yields - level end of period	1.9	1.9	2.5	2.4	2.4	2.3
10Y government bond yields - change compared w/ 2015	1.2	1.2	1.2	1.1	1.2	1.1

Note: The stress scenario covers the period 2016-18. Eurostat's calculation for unemployment rate.

Source: The ESRB and own calculations

The stress test covers 51 banks in 15 countries, corresponding to more than 70% of the total assets of the European banking sector. Moreover, the national supervisory authorities have decided to stress test other banks in addition to this sample

For Denmark, Danske Bank, Nykredit and Jyske Bank have participated in the 2016 EU-wide stress test in the context of the EBA. Furthermore, the Danish FSA has carried out similar stress tests of Sydbank to achieve a higher coverage of the Danish banking sector. Sydbank has also participated in the EU-wide stress tests in previous years.

All four Danish participants were subject to the same macro-economic scenarios, methodology, reporting requirements and quality assurance. Overall, the stress test covers more than 90 per cent of the total assets of the Danish banking sector, and all institutions participated at group level. The results are based on the financial statements and capital items end-2015 and are calculated assuming a static balance sheet and without including any future management initiatives.

The result of the stress test shows that the four Danish institutions in the stress scenario will maintain a Common Equity Tier 1 capital ratio (CET1) in the interval 12.6-14.2 per cent at the end of 2018. All four institutions thus - albeit to varying degrees - have excess capital to the gradually and fully phased-in capital requirement for CET1 (minimum requirement, pillar II and capital buffer requirement), see table 2. Among other things, this reflects a relatively favourable level for CET1 at the outset end of 2015, which is again attributable to the build-up of capital in recent years.

Table 2: Common Equity Tier 1 capital in basic and stress scenarios

Common Equity Tier 1 (CET1) - percent of total risk exposure amount (REA)	Danske Bank	Nykredit	Jyske Bank	Sydbank
CET1, at the end of 2015	16.1	19.4	16.1	14.5
Baseline scenario, at the end of 2018	17.7	22.5	19.8	16.6
Stress scenario, at the end of 2018, gradually phased-in CRR/CRD4 (full phase-in in brackets)	14 (14)	14.2 (13.9)	14 (14)	12.6 (12.6)
Capital requirement, at the end of 2018, gradually phased-in CRR/CRD4 (full phase-in in brackets)	10.3 (11.5)	10.1 (11.1)	9 (9.9)	8.1 (9)
Excess capital, at the end of 2015	8.1	10.7	8.7	8.1
Stress scenario, at the end of 2018, gradually phased-in CRR/CRD4 (full phase-in in brackets)	3.7 (2.5)	4.1 (2.7)	5 (4.1)	4.5 (3.7)

Note: The capital requirement in the adverse scenario is calculated as the minimum requirement + 56% of pillar II (calculated at the end of 2015) + capital preservation buffer + SIFI buffer (depending on institution). Loss absorbing capital is not included.

For total own funds, a similar excess capital is shown, calculated under gradually phased-in CRR/CRD4 regulations at the end of 2018, i.e. with the regulations applicable at this time. Excess capital in the stress scenario is lower with fully phased-in CRR/CRD4, see table 3, and Jyske Bank will have a small capital shortfall in relation to the capital conservation buffer in the stress scenario end-2018, if it is assumed that CRR/CRD4 is fully phased in at this time. However, in such a situation, Jyske Bank will still be in compliance with the solvency need and SIFI buffer by a substantial margin.

The lower excess capital in the fully phased-in CRR/CRD4 reflects e.g. the increasing capital requirements, as well as an outflow of Additional Tier 1 capital and Tier 2 capital, which is not in compliance with the requirements in CRR/CRD4 under full phase-in.

Table 3: Total own funds in the basic and stress scenario

Total own funds - percent of total risk exposure amount (REA)	Danske Bank	Nykredit	Jyske Bank	Sydbank
Own funds, at the end of 2015	21.0	23.9	17.0	17.6
Baseline scenario, at the end of 2018	22.7	27.1	20.7	19.4
Stress scenario, at the end of 2018, gradually phased-in CRR/CRD4 (full phase-in in brackets)	18.9 (17.3)	17.8 (17.4)	14.5 (14.4)	15.3 (14.8)
Capital requirement, at the end of 2018, gradually phased-in CRR/CRD4 (full phase-in in brackets)	14.9 (16.2)	15.3 (16.3)	13.6 (14.5)	12.4 (13.2)
Excess capital, at the end of 2015	9.5	8.5	6.2	7.7
Stress scenario, at the end of 2018, gradually phased-in CRR/CRD4 (full phase-in in brackets)	3.9 (1.1)	2.5 (1.1)	0.9 (-0.1)	2.9 (1.6)

Note: The capital requirement in the adverse scenario is calculated as the minimum requirement + pillar II (calculated at the end of 2015) + capital preservation buffer + SIFI buffer (depending on institution), or under Basel II transitional arrangements (the Basel I floor) if this is the binding requirement.

Contrary to previous European stress tests, in 2016, no pass/fail threshold has been set. Instead, the result of the stress test must be included in the ongoing supervisory work, including the assessment of whether the capital position of individual banks is sufficient.

The stress test has been carried out on the basis of the methodology laid down by the EBA. However, the EBA has allowed for certain deviations in the method in situations where the method does not give a true and fair presentation. For example, cost saving as a consequence of changes in staff levels in 2015 may be recognized in the stress test, even though this is a deviation from the method. Deviations in the form of relaxing constraints in the EBA's methodology have a very limited effect on the stress test results for Danish banks.

The results have been subject to the Danish FSA's quality assurance to ensure sufficiently prudent projections in the stress scenario. For some institu-

tions, quality assurance has given rise to an adjustment of the results in a more prudent direction. Quality assurance takes into account different business models, including that, historically, Danish mortgage loans have generated very low loan impairment losses, among other things due to strict requirements for lending limits (LTV's).

The EU stress test 2016 has been coordinated by the EBA in cooperation with the national authorities (in Denmark, the Danish FSA), the European Commission and the ECB/ESRB.