THE DANISH FINANCIAL SUPERVISORY AUTHORITY

MEMORANDUM

The Danish Financial Supervisory Authority
29 September 2016

Statement on thematic review at Sydbank A/S (new lending to owner-occupied dwellings and co-operative dwellings in growth areas)

Introduction

In the first half of 2016 the Danish FSA conducted a thematic inspection at Sydbank A/S.

The objective was to assess the bank's risk tolerance in connection with new loans to fund owner-occupied dwellings and co-operative dwellings in growth areas as well as to assess the bank's basis for decision and compliance with credit policy and business procedures.

The growth areas had been defined as the municipality of Copenhagen and its suburban municipalities as well as the municipality of Aarhus. The thematic inspection formed part of a cross-sector review involving the five largest banks (SIFI banks).

Summary and risk assessment

The Danish FSA had selected 214 approvals of newly established or increased housing loans provided against mortgages on owner-occupied dwellings and co-operative dwellings to be reviewed by the bank according to detailed instructions. On the basis of the bank's registrations the Danish FSA randomly selected 50 approvals for review.

In January 2016 the Danish FSA issued a guidance on prudence in the credit evaluation as regards housing loans in growth areas. The loans reviewed had been approved in the period from 1 January to 31 October 2015, ie before the guidance.

As a consequence of the very low level of interest rates and recent years' price increases of dwellings in growth areas, there is a risk that the prices of such dwellings may drop significantly. When approving housing loans in growth areas, banks must therefore take extra care to ensure that clients' finances are sound. The review of the approvals indicated that the bank to a large extent have had focus thereon in 2015.

Consequently the Danish FSA assessed that the bank’s risk tolerance in 2015 was low compared to the average for the banks inspected.

The bank’s credit policy did not contain overall explicit requirements to clients’ financial ratios, but relevant principal rules for defining the board of directors’ preferred risk profile as regards retail clients.

The selected approvals deviated from one or more of the bank’s own principal rules in half of the cases. For example, the bank accepted in many instances – as did the other banks inspected – a higher leverage than recommended by the credit policy. The leverage is the client’s total debt divided by the client’s annual gross income. The significant extent of deviations represent a risk that the bank, due to the competitive environment in the growth areas, has made approvals which deviate from the preferences of the board of directors. However it should be noted that the share of approvals which deviate from the principal rules would have been considerably lower if all the bank’s new approvals had been included in the review. The reason is that prior to the selection, the Danish FSA had eliminated the most financially solid clients.

Therefore the bank was ordered to ensure that the credit policy is supplemented by guidelines regarding when and under which circumstances the board of directors may accept deviations from the principal rules.

The Danish FSA found that there were many errors and omissions in the basis for decision. In 28% of the approvals the errors and omissions were material in respect of the calculation of assets, disposable amount and leverage. Moreover there were material omissions in the customer relationship description. The share of material errors and omissions was higher than that of the other banks inspected and the bank’s basis for decision was the poorest among the banks. However the extent of errors and omissions does not change the conclusion that the bank’s risk tolerance in 2015 was low compared to the average for the banks inspected. The bank was ordered to ensure that the basis for decision is improved so that credit decisions are made on a true and adequate basis.