



Extract from the report to the
Public Accounts Committee on
the Financial Stability Company

May
2012

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I. Introduction and conclusion

1. This report is about the taking over and winding up of distressed banks by the Financial Stability Company¹⁾ (the FSC). The Public Accounts Committee has asked Rigsrevisionen to examine how the FSC performs these tasks. The study was launched by Rigsrevisionen in October 2011.

2. The FSC was established as a fully government-owned limited company in October 2008 as part of an agreement between the Danish government and the financial sector to ensure financial stability in Denmark. The agreement was made in response to the impact of the international crisis on the financial sector.

Since 2008, the FSC has taken over and is currently winding up 12 distressed banks. The FSC takes over banks that, according to the Danish Financial Supervisory Authority (the Danish FSA), are not complying with the statutory solvency requirement, and which are not candidates for being taken over by other banks. Rather than being wound up by the FSC, a distressed bank may also, as in the past, decide to declare bankruptcy.

3. When a distressed bank is wound up by the FSC, the FSC initially seeks to divest the parts of the distressed bank that can be sold directly to other banks. Remaining activities will subsequently be wound up by the FSC through divestment, loan servicing or amortisation.

4. The objective of the study is to assess whether the FSC takes over and winds up distressed banks in a satisfactory manner.

The report answers the following questions:

- Has the FSC taken over distressed banks in a satisfactory manner?
- Is the FSC ensuring that the interest terms offered to the customers are determined in compliance with legislative requirements?
- Is the FSC winding up the activities of the banks taken over in a satisfactory manner?
- Is the FSC managed economically?

The solvency requirement as stated in the Danish Financial Business Act

The capital base of a bank shall be of an appropriate size, type and composition to cover the exposures of the bank. The minimum requirement is that the capital base shall constitute 8 per cent of the risk-weighted items. The management of the bank is responsible for determining the bank's solvency requirements. The Danish Financial Supervisory Authority may, however, decide to raise the solvency requirement.

In the report the term "activities" is referring to the assets and liabilities that Finansiel Stabilitet takes over from the distressed banks.

¹⁾ Publicly owned company established to contribute to ensuring financial stability in Denmark in particular by taking over and winding up distressed banks.

MAIN CONCLUSION

Since its establishment in 2008, the FSC has been involved in resolving an important task, which is meant to contribute to ensuring financial stability in Denmark. The range of tasks that are performed by the FSC has been expanded as the financial crisis has developed. The extent and duration of the crisis make it difficult for the FSC to wind up distressed banks.

Rigsrevisionen's study has shown that the FSC takes over and winds up distressed banks in a satisfactory manner. Through legal investigations, the FSC has identified and followed up on potential breaches of law in the banks taken over. The external assessments performed on behalf of the FSC have shown that the processes governing the divestment of the directly saleable parts of the distressed banks have been open and transparent. The same applies to the processes governing property sales that have been reviewed by Rigsrevisionen. The FSC has also in general managed its activities economically.

Rigsrevisionen is, however, of the opinion that the FSC should operationalise the requirement for quick winding-up of the activities of the banks taken over into well-defined objectives and benchmarks to ensure progress and transparency in the winding-up process.

Rigsrevisionen is also of the opinion that the FSC should take appropriate action to ensure that the subsidiaries implement the interest rates on loans announced by the FSC, to the widest possible extent.

Last, Rigsrevisionen finds that the FSC, in connection with each individual take-over of a distressed bank, should re-negotiate the salary of the managing director and fix remuneration for the board of directors to ensure that salaries and remunerations are in compliance with the guidelines laid down by the government and the FSC, and as such reflecting that focus is on economy. This measure was not taken when the FSC took over Amagerbanken.

The main conclusion is based on the following sub-conclusions:

Has the FSC taken over distressed banks in a satisfactory manner?

The FSC has taken over distressed banks in a satisfactory manner. External assessments show that the FSC has divested directly saleable parts of the banks in open and transparent processes. If considered financially viable by the FSC, an independent auditor has been commissioned to assess the value of the banks prior to the divestment. Rigsrevisionen finds that the FSC should set up well-defined criteria for the circumstances in which external assessments should be carried out.

The subsidiaries of the FSC have through legal investigations identified potential breaches of law in the banks that have been taken over by the FSC. The FSC has followed up the conclusions of the legal assessments by involving the Danish Financial Supervisory Authority in the cases involving potential criminal liability, and by filing suits for compensation when considered justified by the legal advisers. The FSC also expects to report the independent auditors to the Danish Accounting Practices Board in the cases where the conclusions made by the legal advisers indicate breaches of generally accepted auditing standards.

Rigsrevisionen finds that the legal investigations procured by the FSC are subject to the regulations of the Danish Public Procurement Act and the EU Procurement Directive. The FSC is currently resolving how its future procurement of legal services to conduct legal investigations can meet the requirements of these regulations.

Is the FSC ensuring that the interests terms offered to the customers are determined in compliance with legislative requirements?

The FSC has announced to the subsidiaries the interest rates that they are to apply to the loans of their customers. These interest rates are in compliance with the legal requirements. The purpose of these requirements is, among other, to ensure that the subsidiaries do not compete with the interest rates generally offered in the Danish banking market.

The majority of the exposures of the subsidiaries operate with an actual interest rate on loans that is lower than the announced rates of interest. The reason is partly that the announced interest rates are not fully implemented in the subsidiaries and partly that some of the exposures are subject to interest deferral agreements or interest rates having been reset to zero. Therefore the actual interest rates on these loans do not reflect the announced interest rates. Rigsrevisionen finds that the FSC should ensure that the interest rates announced are implemented by the subsidiaries to the widest possible extent.

Is the FSC winding up the activities of the distressed banks in a satisfactory manner?

The FSC is winding up the activities of the banks taken over in a satisfactory manner. The activities are wound up continuously and the processes governing the property sales that were reviewed by Rigsrevisionen have been open and transparent.

The FSC monitors the winding up of activities on the basis of a number of key performance indicators relating to the subsidiaries' ability to keep their budgets, and through representation on the boards of most of the subsidiaries.

Rigsrevisionen finds that the FSC should define objectives and benchmarks for winding up the activities of the banks taken over up to the point when they are expected to be fully wound up. Rigsrevisionen is aware that external factors may affect achievement of the objectives and benchmarks set. The objectives and benchmarks will in such cases serve the purpose of ensuring openness and transparency in relation to the progress of the winding-up activities.

Is the FSC managed economically?

The FSC has generally ensured that the company is run economically.

The salary level for the managing director and the remuneration for the board of directors of the FSC and the subsidiaries are in compliance with the guidelines laid down by the government, and are reflecting considerations of economy. However, this does not apply to the managing director of the subsidiary Amagerbanken whose salary was among the highest in the market. It appears from the government's guidelines on salaries in government-owned limited companies that salaries paid should not be among the highest in the respective markets. Also the level of remuneration paid to the board of directors of Amagerbanken is considerably above the level indicated in the guidelines developed by the FSC.

Rigsrevisionen finds that in the future the FSC should ensure that contracts with managing directors and remuneration for the boards of directors of banks that are taken over should be re-negotiated and fixed at a level that is in compliance with the guidelines of the government and the FSC and reflect considerations of economy.

The leasehold expenses of the FSC are not exceeding the average costs of commercial leases in Copenhagen. Rigsrevisionen has reviewed a number of the company's entertainment cost items. The cost items reviewed were all considered reasonable.