



29th meeting of the Systemic Risk Council

23 June 2020

The Systemic Risk Council

www.risikoraad.dk

mail@risikoraad.dk

The covid-19 outbreak and the measures taken to contain the virus have caused a sudden, rapid decline in economic activity, both internationally and in Denmark. The full extent of the negative impact remains uncertain, and the economic downturn could be deep and prolonged. The release of the countercyclical capital buffer gives institutions more scope to maintain lending. The Council does not expect to recommend an increase of the buffer rate until 2021 at the earliest.

The covid-19 outbreak has caused a significant slowdown in economic activity

The rapid spread of covid-19 and the measures taken to contain the virus have caused a significant slowdown in economic activity, both globally and in Denmark. In late February and early March, growing uncertainty sent equity markets in the USA and Europe plunging. This emphasises that changes in the risk perception of financial markets may occur suddenly and result in wide fluctuations in a short period of time. A number of central banks responded by easing monetary policy. Market participants expect interest rates to remain low for a prolonged period of time.

The extent of the negative impact, both for the Danish economy and the banking sector, remains highly uncertain. A prolonged recession could have negative impact for banks both in the medium and long term. Lending to non-financial corporations in industries affected by the covid-19 outbreak accounts for a substantial proportion of bank lending and will result in higher credit risk for some time. Going forward, risks may arise if banks' credit standards become too lax or exposures to vulnerable customers increase considerably. On the other hand, risks may also materialise if banks severely tighten credit standards in an attempt to minimise losses.

The housing market has seen a recovery in trading activity after a temporary drop in March and April, which has also caused a slight decline in house price. Prospects of continued low interest rates are likely to buoy up the housing market going forward. The borrower based measures implemented in recent years have helped to underpin household resilience.

The countercyclical capital buffer

On 12 March 2020, the Minister for Industry, Business and Financial Affairs decided to release the countercyclical capital buffer in response to covid-19. Releasing the buffer should discourage banks and mortgage credit institutions from becoming reluctant to provide loans due to insufficient capital.

In recent years, the Council has focused on increasing the resilience of credit institutions through a gradual increase of the countercyclical capital buffer. The aim was to build a buffer of sufficient size to make a difference when it became necessary to release it. Re-

leasing the buffer after the covid-19 outbreak is therefore in line with the Council's approach to the buffer.

The Council does not expect to recommend an increase of the buffer rate until 2021 at the earliest. The timing of the recommendation and the pace of building up the capital buffer will depend on developments in financial risks. Following a decision to raise the buffer rate, banks have 12 months to comply with the requirement as a starting point. This means that institutions would not be expected to meet a positive buffer requirement until 2022 at the earliest.

Temporary reduction of the general systemic risk buffer and changing the criteria for SIFI designation in the Faroe Islands

On 18 March, in response to the challenges presented by the spread of covid-19, the Council recommended to the Minister for Industry, Business and Financial Affairs that the general systemic risk buffer on the Faroe Island be temporarily reduced to 2 per cent. The Minister followed the recommendation.

In early March 2020, the Systemic Risk Council recommended to the government that a lower limit be introduced for when credit institutions in the Faroe Islands can be designated as systemically important financial institutions. On 4 June, the Minister for Industry, Business and Financial Affairs published a [press release](#) stating that the government has decided to adjust the model for designation of systemically important financial institutions (SIFIs) in the Faroe Islands. The adjustment will introduce a lower absolute limit of kr. 3 billion on the size of balance sheets. This limit is to ensure that Faroese banks can be designated as SIFIs only if they are effectively systemic.

Other issues

The Council discussed potential systemic risks in relation to the recovery and resolution of pension funds and life insurance companies. The Danish pension sector manages a large share of household wealth and is a major player in the financial markets.

For further information, please contact mail@risikoraad.dk or *Teis Hald Jensen*, Communications and Press Advisor, on tel. +45 3363 6066.