



Report to the Public Accounts
Committee on the Danish Financial
Supervisory Authority's activities
in relation to Roskilde Bank A/S

June
2009

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Rigsrevisionen submits this report to the Public Accounts Committee in accordance with sections 8(1) and 17(2) of the Auditor General's Act, see Consolidated Act No. 3 of 7 January 1997 as amended by Act No. 590 of 13 June 2006.

The report concerns section 8 of the Fiscal Act. The Ministry of Economic and Business Affairs.

In the period during which the examination was conducted, the ministry was headed by the following ministers:

Bendt Bendtsen: 27 November 2001 - 10 September 2008

Lene Espersen: 10 September 2008 -

I. Introduction and results

1. This report deals with the Danish Financial Supervisory Authority's (FSA) supervisory activities viewed in the light of the Roskilde Bank A/S case. The report is based on questions asked by the Public Accounts Committee following a request from the Finance Committee of the Folketing in September 2008.

2. The information on which the report is based includes confidential information provided to Rigsrevisionen by the FSA. The Ministry of Economic and Business Affairs and the FSA find that the report may be published in its existing form according to the usual procedure.

3. The Ministry of Economic and Business Affairs is responsible for monitoring the financial sector through the FSA, which is responsible for supervising financial services companies, including banks. According to the Financial Services Act, the FSA must check that banks comply with the act and the rules issued in pursuance of the act. In 2007, risk-based supervision was formalized by statute stipulating that the organization of supervisory activities must be proportionate to the risk or detrimental effects of violations of the financial legislation. Prior to this legislative amendment, the supervision of financial services companies was based in practice on the same principles, as appears from the FSA's performance contract.

4. In July 2008, Roskilde Bank A/S approached the FSA to find a solution to the bank's financial situation by way of a cash contribution or merger. The solution adopted was for Danmarks Nationalbank (Nationalbanken) to make the necessary cash available to Roskilde Bank A/S. The bank's loan portfolio was subsequently subjected to a detailed investigation by its external auditors concluding that Roskilde Bank A/S no longer complied with the statutory capital adequacy requirement.

5. The Finance Committee approved Appropriation 199 4/9 2008 concerning a state guarantee to cover any losses incurred by Nationalbanken on the extraordinary cash contribution provided to Roskilde Bank A/S. Against this background, the Finance Committee found that the FSA's activities in general, and in particular those relating to Roskilde Bank A/S and Bank Trelleborg A/S, should be subjected to an audit examination. The Finance Committee subsequently approved Appropriation 25 27/11 2008 extending the state guarantee to include any losses incurred in connection with Nationalbanken's takeover and winding-up of Roskilde Bank A/S.

6. The purpose of the examination is to evaluate the FSA's supervisory activities in relation to Roskilde Bank A/S, including whether Roskilde Bank A/S' problems came as a surprise to the FSA. This is examined by answering the questions of the Public Accounts Committee listed in appendix 1. Rigsrevisionen has divided these questions into the following four main categories:

- 1) Does the FSA carry out risk-based supervision of banks?
- 2) How has the FSA supervised Roskilde Bank A/S?
- 3) Are the measures taken in relation to Roskilde Bank A/S appropriate?
- 4) Is the framework for the FSA's activities appropriate?

Roskilde Bank A/S was Denmark's 8th largest bank with a balance sheet of just under DKK 43bn at 31 March 2008 and 105,000 customers, of whom 90,000 were private customers.

7. The Ministry of Economic and Business Affairs has stated that on the basis of the questions asked by Rigsrevisionen for the purpose of the examination, the ministry and the FSA have provided all relevant material relating to the issue.

MAIN FINDINGS AND CONCLUSIONS

The FSA has supervised Roskilde Bank A/S according to the relevant guidelines, including those governing the supervision of banks subject to stricter supervision. The FSA was aware of Roskilde Bank A/S' problems, but failed to conduct a sufficiently systematic follow-up. Overall, Rigsrevisionen finds that, given the FSA's knowledge of Roskilde Bank A/S' situation, it ought to have intensified its follow-up and fully maintained its estimate of the bank's capital adequacy need.

Measures to strengthen the FSA's follow-up and impact have been introduced because in future, banks must publish their individual capital adequacy needs and the FSA may publish any risk factors they fail to act upon.

This overall assessment is based on the following:

The FSA has carried out satisfactory risk-based supervision. Supervisory activities are planned on the basis of a rating model, whose data basis may be improved, for example, by including data from the quarterly monitoring of banks. In addition, supervision may be improved by tightening the FSA's follow-up procedures.

- The FSA's rating model consists of a technical rating based on bank accounting figures. The technical rating is supplemented by a subjective evaluation based on the FSA's knowledge of the company.
- The FSA carried out risk-based supervision both before and after the legislative amendment in 2007. The rating should include the quarterly bank monitoring to ensure that the inspection programme for this year and next is based on updated data.
- In 2006, the FSA established a procedure to follow up separately on the more critical instructions issued. However, the same procedure should be adhered to in relation to other instructions and special risk factors for banks on the watch list or subject to stricter supervision.
- It would also be appropriate if the bank's external auditors were required to account for the bank's compliance with instructions unlike today, where auditors need only include comments in the audit book entry if an instruction has not been complied with.
- The final reporting to the banks does not distinguish clearly between critical and less critical situations. This is a particular problem when several of a bank's business areas are being investigated because a large number of reprimands, instructions and risk factors may be involved.

The FSA has supervised Roskilde Bank A/S according to its guidelines, including those governing the supervision of banks subject to stricter supervision. However, the FSA failed to fully maintain its estimates of the bank's capital adequacy need and follow up systematically on instructions and risk factors. Rigsrevisionen finds that on the basis of its knowledge of Roskilde Bank A/S' circumstances, the FSA ought to have intensified its follow-up.

- During the period 2005-2007, the FSA carried out annual inspections of Roskilde Bank A/S, which is in accordance with the inspection frequency for banks, including those subject to stricter supervision. Roskilde Bank A/S has been subject to stricter supervision since 2006.
- The problems at Roskilde Bank A/S came as no surprise to the FSA. The FSA highlighted procedural problems as early as 2005, advising the bank of a number of risks, including its growth in lending, industry focus and share in major accounts.
- The only instruments applied by the FSA in relation to Roskilde Bank A/S were instructions and risk factors.
- In neither 2006 nor 2007 did the FSA maintain its estimate of the bank's capital adequacy need.
- The FSA ought to improve the model used to determine real property values and establish procedures for the timing of adjusting capital adequacy needs or write-downs. These developments are necessary to provide uniform FSA decisions.
- The FSA knew of the problems at Roskilde Bank A/S, but failed to follow up on compliance with instructions. The FSA ought to have actively monitored developments in the issues concerned and refrained from relying on the executive order on bank audits, according to which auditors are required to check that FSA instructions are complied with.
- In the period 2005-2007, Roskilde Bank A/S' external auditors made no comments about non-compliance with instructions. The FSA has been unable to inform Rigsrevisionen of whether all instructions issued to Roskilde Bank A/S have been complied with. As regards the possible lack of follow-up on the part of the auditors, the FSA is investigating whether the internal and external auditors discharged their duties properly in relation to Roskilde Bank A/S. Rigsrevisionen believes there are good reasons for the FSA to look into the auditors' performance.
- In January 2005, accounting rules were changed to the effect that banks could no longer make provisions for probable losses. Rigsrevisionen is unable to establish the significance of the changed accounting rules for the amount of write-downs on loans in Roskilde Bank A/S, because it is impossible to estimate how the bank would have acted under the previous accounting rules. Nationalbanken notes that over the past few years, Danish banks have generally built up lower loss buffers, which may partly be due to the changed accounting rules in combination with the changed capital adequacy rules.
- The FSA has included the relevant management aspects and viewpoints put forward in 1996 by the former bank auditor. However, these did not prompt the FSA to carry out a special investigation of the bank management.

The two measures taken in relation to Roskilde Bank A/S were developed ad-hoc, implemented on the basis of a number of assumptions made by the Ministry of Economic and Business Affairs and established under extreme time constraints. In the course of the investigation, the Ministry of Economic and Business Affairs procured the necessary statutory authority to leave the actual winding-up of Roskilde Bank A/S to the central government winding-up company (the Financial Stability Company).

- In its choice of measures to be taken, the Ministry of Economic and Business Affairs chose to balance various considerations and followed the principles set for such measures. In compliance with European Central Bank guidelines, the ministry involved Nationalbanken in the initial phase – liquidity support to Roskilde Bank A/S.
- The Private Contingency Association's contribution of DKK 750m to the liquidity support for Roskilde Bank A/S equals the assets of the Private Contingency Association. The amount of support was negotiated by Nationalbanken, the Private Contingency Association and the Ministry of Economic and Business Affairs. No calculation of the amount of private support required thus exists.
- After the Financial Stability Company was established, the winding up of Roskilde Bank A/S continued under the auspices of Nationalbanken. Rigsrevisionen finds that in the circumstances, Nationalbanken could be brought in as a temporary player. Rigsrevisionen notes that in the course of the investigation, the Ministry of Economic and Business Affairs procured the necessary statutory authority to leave the actual winding-up of Roskilde Bank A/S to the central government winding-up company. Rigsrevisionen finds that there are good reasons for the Ministry of Economic and Business Affairs' initiative to procure statutory authority for the transfer of Roskilde Bank A/S.
- Appropriation No. 199 was adopted on 4 September 2008. Before the adoption, more than DKK 4bn was drawn on the credit facility with Nationalbanken. Rigsrevisionen notes that the Ministry of Economic and Business Affairs informed the Finance Committee of the drain on the credit facility at the committee consultation in August 2008.

The FSA has had sufficient financial resources but difficulties in attracting and retaining staff, including credit specialists. The FSA's confidentiality rules have been changed to the effect that in future, the public will be able to learn more about the financial position of financial services companies.

- The appropriation relating to the FSA is covered by charges paid by the enterprises that the FSA supervises. Although the FSA's appropriation has been sufficient, the FSA has been unable to utilize it and thus accumulated a pay bill surplus over the years.
- Recent years' staff turnover at the FSA has exceeded the government average, but vacancies have continuously been re-filled. However, the FSA has had problems attracting certain types of specialists, and the group of inspection managers has been reduced, which has increased the FSA's vulnerability in terms of implementing supervisory activities.

- The FSA confidentiality rules have been amended to enable the disclosure of confidential information to the Finance Committee in connection with handling crises in financial services companies. Furthermore, the FSA may now prepare a public statement explaining the background to the winding up of a bank and the related government involvement. Further, Rigsrevisionen notes that in future, the FSA may lay down rules governing publication of the companies' individual capital adequacy needs and any non-compliance with risk factors.

II. Preface

A. Background

8. This report deals with the Danish Financial Supervisory Authority's (FSA) supervisory activities viewed in the light of the Roskilde Bank A/S case. The report is based on questions asked by the Public Accounts Committee following a request from the Finance Committee of the Folketing in September 2008.

9. The information on which the report is based includes confidential information provided to Rigsrevisionen by the FSA. The Ministry of Economic and Business Affairs and the FSA find that the report may be published in its existing form according to the usual procedure. The FSA has stated that it will arrange for the drafting of a special memorandum, see section 352 a of the Danish Financial Services Act, to be published concurrently with Rigsrevisionen's report.

10. The Finance Committee approved Appropriation 199 4/9 2008 concerning a state guarantee to cover any losses incurred by Nationalbanken on the extraordinary cash contribution provided to Roskilde Bank A/S. Against this background, the Finance Committee found that the FSA's activities in general, and in particular those relating to Roskilde Bank A/S and Bank Trelleborg A/S, should be subjected to an audit examination. The Finance Committee subsequently approved Appropriation 25 27/11 2008 extending the state guarantee to include any losses incurred in connection with Nationalbanken's takeover and winding-up of Roskilde Bank A/S.

11. The Ministry of Economic and Business Affairs is responsible for monitoring the financial sector through the FSA, which is responsible for supervising financial services companies, including banks. The FSA organizes its supervision of financial services companies in consultation with the Financial Services Council and the Danish Securities Council, contributes to the drafting of financial legislation, and collects and communicates financial sector statistics and key figures.

12. Recent years' turbulence in the financial markets and the resulting problems faced by several Danish banks have heightened focus on the FSA's supervisory tasks vis-à-vis the banks and caused an amendment of the Financial Services Act towards the end of 2008. Similarly, in connection with the Act on Financial Stability (bank package I) and the Act on Capital Injections into Credit Institutions (bank package II), extra resources have been allocated to the FSA to strengthen the supervision of the banks, including an annual review of the capital adequacy needs of all banks to be conducted in future.

13. The question of the FSA's organizational placement was raised in connection with the examination. Rigsrevisionen has examined the placement of supervisory authorities in other countries and has established that in addition to Denmark, Sweden, Norway and the UK also have supervisory authorities that are independent of the central bank. Ultimately, the government decides where the FSA should be placed. Nationalbanken has stated that changing the placement of the FSA is likely to require new legislation. In this connection, Rigsrevisionen refers to the examination of the UK Financial Services Authority conducted

The Financial Services Council is part of the FSA and the ultimate decision-maker in supervisory cases of fundamental importance. The council has eight members, six of whom have been appointed on the proposal of trade associations.

The Danish Securities Council is part of the FSA and decision-maker in supervision cases of fundamental importance – in particular those of importance to securities trading.

Capital adequacy need is a bank's assessment of its minimum capital adequacy requirement. See the glossary of appendix 2.

by the NAO, the UK supreme audit authority. One of the NAO's conclusions was that the distribution of duties between the supervisory authority, the Ministry of Finance and the central bank is appropriate. This structure resembles that used in Denmark where the Ministry of Economic and Business Affairs, including the FSA, the Ministry of Finance and Nationalbanken cooperate together in the Financial Stability Coordination Committee. The committee's focus areas include information collection and exchange, international cooperation and consultations in connection with changes to rules or principles.

B. Purpose, delimitation and method

Purpose

14. The purpose of the examination is to evaluate the FSA's supervisory activities in relation to Roskilde Bank A/S, including whether the Authority intervened early enough.

This is examined by answering the questions of the Public Accounts Committee listed in appendix 1. Rigsrevisionen has divided these questions into the following four main categories:

- 1) Does the FSA carry out risk-based supervision of banks?
- 2) How has the FSA supervised Roskilde Bank A/S?
- 3) Are the measures taken in relation to Roskilde Bank A/S appropriate?
- 4) Is the framework for the FSA's activities appropriate?

Re 1) and 2). The answers to the following questions asked by the PAC are included in chapters III and IV:

- How has the FSA carried out risk-based supervision since 1 July 2007 and what were the consequences of this approach in relation to Roskilde Bank A/S?
- Did Roskilde Bank A/S' problems come as a surprise to the FSA, or has Roskilde Bank A/S been subject to stricter supervision in recent years?
- What significance did the tax rules on write-downs have for Roskilde Bank A/S?
- Did the FSA issue instructions to Roskilde Bank A/S – and if so, what were the results?
- To whom and when must the FSA report when it becomes aware of danger signals and problems in a bank? Was such reporting made in the case of Roskilde Bank A/S?
- How did the FSA follow up on the statement issued in 1997 by the former auditor of Roskilde Bank A/S?

Re 3). The answer to the following question asked by the PAC is included in chapter V:

- What calculation basis is used for the banks' agreement with Nationalbanken that they are required to cover precisely DKK 750m through the Private Contingency Association?

Re 4). The answers to the following questions asked by the PAC are included in chapter VI:

- In 2007, why did the FSA record a just under 25% turnover in staff and how many positions in the FSA have remained vacant? Is this turnover normal, which staff groups are involved, and is the FSA in a position to recruit the required expertise?
- Is confidentiality necessary, or could the FSA and/or the financial services sector provide the public with more information about various risks? Are legislative amendments in the field expected to improve reporting?

The following questions are also answered in chapter III:

- Did the Ministry of Economic and Business Affairs follow up sufficiently on the criticism levelled in report no. 17/04 on the FSA's activities that was concluded by Rigsrevisionen's memorandum of 24 January 2008 to the PAC?

The criticism concerned:

- supervision uniformity, particularly as regards the use of status forms
- inspection frequency for large enterprises
- use of administrative fines.

Delimitation

15. The PAC posed these questions at its meeting in September 2008 before the two bank packages had been adopted. Accordingly, Rigsrevisionen has not audited their implementation. Thus, the winding-up company that was established on the basis of the first bank package to ensure financial stability, hereinafter the Financial Stability Company, was not independently the subject of the examination, but the company is to some extent included in the conclusions that deal with the measures taken in relation to Roskilde Bank A/S. Similarly, the examination conclusions will deal with areas in respect of which the FSA's tasks have changed as a result of the bank packages.

16. The FSA supervises a range of financial services companies, but Rigsrevisionen has solely examined the FSA's supervisory activities relating to banks.

17. The questions asked by the PAC also concerned Bank Trelleborg A/S. The Ministry of Economic and Business Affairs has stated that the bank's minority shareholders have instituted proceedings against the FSA before the Eastern High Court concerning the completed compulsory redemption of the minority shareholders' shares in Bank Trelleborg A/S. Consequently, the report does not deal with the FSA's activities in connection with Bank Trelleborg A/S.

18. The examination covers the FSA's activities during the period 2005-2008.

19. The Ministry of Economic and Business Affairs has stated that the ministry and the FSA have provided all relevant case material in response to the questions asked by Rigsrevisionen for the purpose of the examination.

Method

20. The examination is based on a review of written material, including acts and executive orders. The Ministry of Economic and Business Affairs and the FSA have prepared a number of memoranda for the purpose of the examination. Moreover, the examination is based on interviews with the Ministry of Economic and Business Affairs, the FSA and the Danish Bankers' Association. Finally, Rigsrevisionen discussed certain examination issues with external experts.

21. The draft report was presented to the Ministry of Economic and Business Affairs and the FSA, whose comments have been incorporated in the report to the widest possible extent. In addition, the draft report has been sent to the Ministry of Finance and Nationalbanken for consultation.

22. Central financial services concepts are defined in appendix 2.

III. FSA supervision of banks

MAIN CONCLUSION

The FSA has carried out satisfactory risk-based supervision. Supervisory activities are planned on the basis of a rating model, whose data basis may be improved, for example, by including data from the quarterly monitoring of banks. In addition, supervision may be improved by tightening the FSA's follow-up procedures.

23. Rigsrevisionen has examined the FSA's planning and performance of bank supervision, its application of the instruments available to ensure effective supervision, and its reporting of the outcome of supervision, in particular to banks.

A. Supervision planning and performance

24. According to the Financial Services Act, the FSA must check that banks comply with the act and the rules issued in pursuance of the act. In 2007, risk-based supervision was formalized by statute stipulating that the organization of supervisory activities must be proportionate to the risk or detrimental effects of violations of the financial legislation. Prior to this legislative amendment, the supervision of financial services companies was based in practice on the same principles, as appears from the FSA's performance contract.

FSA rating model

25. The FSA bases its bank rating on a technical rating supplemented by a subjective rating. The technical bank rating is based on a calculation of the capital adequacy need, which is derived from a stress test. The stress test measures the reaction of individual institutions to a range of relatively extreme occurrences, for example, interest rate changes. The stress test is based on data taken from the bank's annual report. In addition to calculating the capital adequacy need on the basis of the stress test, additions or reductions will be made to and from the bank's capital adequacy need depending on the bank's risk profile.

26. The technical rating is supplemented by a subjective rating based on the FSA's knowledge of the company's management, controls and control environment. The FSA has stated that the subjective assessment also includes market information, press coverage, etc. On the basis of this assessment, the FSA prepares a proposal for an inspection programme which is presented to the management in August for final approval in December. This procedure means that in principle, the rating is based on accounting figures and data dating more than two years back. The inspection programme is adjusted regularly on the basis of supplementary information, for example, in the form of quarterly monitoring results.

Enterprises are rated on a scale from 1 to 9, the rates of 1 and 2 not being applied. The higher the buffer, the better the rating. A rating of 3 means the bank will be subject to stricter FSA supervision.

27. To illustrate the model, Rigsrevisionen has obtained information from the FSA about ratings in the group to which Roskilde Bank A/S belongs. The information relates to group 2 developments for the period 2005-2007, and table 1 shows the technical as well as the subjective rating.

Table 1. Group 2 rating

	2005		2006		2007	
	Technical	Subjective	Technical	Subjective	Technical	Subjective
Roskilde Bank A/S	3	4	4	3	6	3
Maximum	7	7	6	6	8	8
Minimum	3	4	3	3	4	3
Group 2 average	5.7	5.2	5.1	5.2	6.0	5.7

Source: FSA.

Group 2 banks are medium-sized credit institutions with capital employed ranging from DKK 10bn to DKK 50bn.

28. Table 1 shows that the average group rating ranges from 5 to 6. In 2005 and 2007, the subjective rating dropped slightly compared with the technical rating. In 2006, the rating increased by 0.1 percentage point. However, the FSA has furthermore stated that some banks have recorded larger deviations. Roskilde Bank A/S' technical rating increased from 3 to 6 during the period, whereas the subjective rating fell from 4 to 3. Throughout the period, the subjective rating for Roskilde Bank A/S was somewhat below average.

Inspection programme

29. The FSA's supervisory activities are divided into two categories: regular monitoring and on-the-spot inspections.

Regular monitoring consists of reviews of audit book entries relating to annual reports, sample accounting checks and several ad hoc activities such as analyses of growth in lending.

On-the-spot inspections may be ordinary or functional inspections. The FSA's ordinary inspections examine an enterprise's most important risk areas, and functional inspections focus on special calculations or functions.

30. The scope and frequency of an inspection depends on the size and rating of the enterprise concerned. All low-rated enterprises, that is, those with a rating of 4 or 5, are placed on an observation list. These enterprises are investigated twice as frequently as other enterprises of the same size, that is, every other year for all large enterprises. Once an enterprise has been allocated a place in the rotation system, the FSA selects area(s) to include in the inspection. The FSA has defined key areas as being those that entail a risk for the enterprise's continued operation, e.g. capital adequacy need, credit risk, market risk and liquidity risk.

31. The FSA has stated that since 2006, it has inspected major banks every three years and thus has increased its inspection frequency over previous years, when inspections were carried out every four years.

32. A rating of 3 means a bank is subject to stricter supervision and to inspection every other year. The inspection covers all material areas, including the bank's assessment of its capital adequacy need and the related documentation. Banks subject to stricter supervision are also subject to relevant annual supervisory activities.

33. Rigsrevisionen has examined the FSA's 2008 inspection programme. The FSA has stated that it spends approx. 1/3 of its working hours on inspections and attempts to distribute activities evenly over the year.

34. The examination has shown that no inspections were performed in the first quarter of 2008, when many FSA staff members took training courses (at the supervision school). The FSA has stated that generally, it tries to exempt the first quarter of the year from inspections, when banks are fully engaged in preparing their annual reports and inspections would otherwise be made on the basis of the previous year's audited accounting figures.

35. Moreover, changes were made to the inspection programme, primarily as a result of bank mergers and the transfer of planned inspections to future years to enable the FSA to carry out inspections of credit institutions considered to be subject to greater risk. The FSA has stated that the changes to the inspection plan were caused in particular by developments in the property market. Table 2 shows that the change in priorities in 2008 led to the FSA completing 70% of the planned inspections. At the same time, the priority of the various areas changed so that overall, the number of inspections completed was 6% higher than planned.

**Table 2. Bank inspections planned and completed in 2008
(Number)**

Planned inspections	54
- of which completed	38
Additional inspections	19
Total inspections	57
Inspections completed as a percentage of inspections planned	70%
Total number of inspections as a percentage of inspections planned	106%

Source: FSA.

The FSA has stated that the priority changes enabled it to maintain the number of inspection weeks and number of banks included in the year's programme, because these factors form part of the FSA's performance contract. The scope of the actual inspection, however, may have been reduced because the FSA omits money-laundering and fit-and-proper rule investigations.

36. The FSA has further stated that the use of property inspectors increased sharply in 2008. According to the FSA, the staff members involved have special experience in carrying out real property valuations. There are also examples of staff members on loan from other offices.

37. The FSA conducts so-called quarterly deviation analyses which highlight banks that, based on several parameters, account for the largest deviations. However, deviation analysis data do not form part of the rating.

38. As mentioned earlier, the FSA regularly monitors financial institutions by reviewing the key figures of quarterly reports and examining inter-bank transfers of exposures written down, growth in lending, interest-rate risk, etc.

39. In audit book entries, external auditors report to the supervisory board on audit issues. In financial institutions, the FSA makes a number of additional requirements regarding the contents of audit book entries issued in conjunction with an annual report, including:

- an auditors' statement that the bank's procedures and internal controls in important areas have been planned and work in a satisfactory manner
- an outline of the ten largest accounts with the auditor's assessment of the risk attaching to each account and a statement that individual accounts have been measured correctly
- a summary of the comments occasioned by the audit with details on status (open or closed)
- a specification of any FSA instructions not complied with.

40. The FSA reviews both internal and external auditors' audit book entries regarding the annual report in order to increase its knowledge of the bank's operations, practices, capital, etc., and on this basis considers whether there are areas requiring supervisory action.

41. The FSA has stated that the review of audit book entries received in connection with the annual reports focuses on the auditor's comments regarding any violation of the law and any instructions from the FSA not yet complied with by the bank.

Status forms

42. Status forms are used to assess compliance with fundamental financial law requirements. In connection with inspections of financial services companies in autumn 2007, the FSA carried out a pilot project using status forms in some areas. Some of these forms are available in different editions, depending on the type of company involved. Status forms are forwarded prior to the inspection and have two formats. The pilot project showed that companies were better prepared for the FSA's questions and that some had gained a better overview of the FSA's focus areas. Based on the experience acquired, the FSA has systematically used status forms in its inspections as from the second quarter of 2008.

43. The Ministry of Economic and Business Affairs has stated that the status forms are an important element in ensuring supervision uniformity. Introducing status forms in all areas is thus one of the FSA's performance targets. According to the FSA's reporting to the ministry in November 2008, the performance target was met.

Assessment

44. The FSA's rating model consists of a technical rating based on bank accounting figures. The technical rating is supplemented by a subjective evaluation based on the FSA's knowledge of the company.

45. The FSA carried out risk-based supervision both before and after the legislative amendment in 2007. The rating should include the quarterly bank monitoring to ensure that the inspection programme for this year and next is based on updated data.

B. Instruments and follow-up

46. In its supervision of the banks, the FSA may, for example, order the management of a financial services company to prepare a statement on the company's financial position and future prospects. The FSA can also exercise other response options depending on the nature of the issue:

- instructions
- reprimands
- penalty payments
- dismissal of executive or supervisory board members
- withdrawal of banking licences
- reporting the bank to the police
- risk factors.

Capital requirement
The capital base of a credit institution must amount to no less than 8% of the institution's risk-weighted items or capital adequacy need, if this is higher than 8%. See the glossary in appendix 2.

47. A distinction can be made between responses commonly applied by the FSA in its supervision of banks and those only applied in particularly critical cases. Banking licences are, for example, not withdrawn until the time when a bank no longer satisfies the statutory capital requirement – and thus in connection with winding up the bank. The FSA has not applied penalty payments since 1999 – and never caused the dismissal of an executive or a supervisory board member.

The FSA may respond if a member of the supervisory or executive board has repeatedly acted dishonestly, for example, by failing to comply with good administrative practice or accounting policy requirements, by failing to initiate adequate control procedures or by putting the financial services company at risk. According to the FSA, cases decided pursuant to the Danish Criminal Code show that a substantial burden of proof is required before the courts can disqualify persons from carrying on specific business.

Rigsrevisionen refers to the fact that the consequences of disqualifying persons from carrying on specific business pursuant to the Criminal Code are more far-reaching than dismissing a member of the executive or supervisory board pursuant to the Financial Services Act.

Instructions and reprimands

48. The FSA's options for issuing instructions and reprimands, the sanctions usually applied in the supervision of banks and thus also in connection with Roskilde Bank A/S, are elaborated on in the following.

49. The FSA issues instructions when a company acts contrary to the law or fails to act where action is required. Since 2006, the FSA has categorized instructions as follows: more critical instructions, critical instructions and less critical instructions. Furthermore, the FSA can instruct a company to take necessary action within a given time limit if:

- 1) the company's financial position has deteriorated to such a degree that the interests of depositors, the insured, bondholders and other investors are jeopardized
- 2) there is a considerable risk that the company's financial position will deteriorate to the point that it will lose its licence.

50. In addition, the FSA issues reprimands in connection with ascertained offences that have been discontinued, such as offences of a temporary nature or offences that the company has rectified at its own initiative.

Risk factors

51. The FSA uses risk factors in cases where it needs to draw attention to an issue without an offence having been committed. Risk factors are divided into two categories: risk factors and special risk factors. Special risk factors are used when there is a high risk of an offence occurring.

Follow-up

52. In its report no. 17/04 on the FSA's activities, Rigsrevisionen pointed out that the FSA was not systematically following up on the instructions that the Authority had issued to banks and that the Authority had subsequently (in 2006) established an instruction follow-up procedure. The more critical an instruction, the less time companies will be given to follow up on the instruction. Moreover, according to the FSA procedure, the Authority must follow up on special risk factors. However, such no follow-up procedure has yet been established.

53. The FSA demands that within a certain time limit, the company management must notify the FSA that the issue for which it received an instruction has been rectified – irrespective of instruction category. The auditors are responsible for subsequently checking whether the issue concerned has been rectified and must report any non-compliance with such instructions in the audit book entry.

54. In addition, if the instruction concerned is more critical, the FSA separately checks compliance with the instruction immediately after the company has confirmed rectification of the issue. In each case, the FSA considers whether a management statement that an issue has been rectified can be considered adequate documentation.

55. The control of critical instructions is performed by the FSA itself or the auditor, in some cases in the first succeeding audit book entry and normally within a few months. The control of less critical instructions is performed at the next inspection or reporting. The control of critical and less critical instructions is thus largely based on the auditor's control of the company's compliance with the instruction. If the auditor does not report on non-compliance in the audit book entry, the FSA assumes that the instructions have been complied with.

Administrative fines

56. Administrative fines are used in several other European countries, but have not yet been introduced in Denmark. As opposed to penalty payments, administrative fines have implications under criminal law. Authority to impose administrative fines is subject to two conditions: a clearly identifiable and uncomplicated offence, and clear, relevant case law, which requires a certain volume of cases to have been decided by the courts.

57. The FSA has looked into the possibility and need to apply administrative fines. According to the FSA, many of the offences identified during the supervisory activities fulfil the first condition. The second condition, however, requires the existence of several uniform cases that the FSA can bring before the courts in order to establish case law.

58. At the same time, the FSA finds that imposition of administrative fines must be possible. For offences under the Financial Services Act, it would be desirable to introduce administrative fines for non- or delayed submission of reporting and erroneous auditing and accounts, for example the absence of a management statement.

Assessment

59. In 2006, the FSA established a procedure to follow up separately on the more critical instructions issued. However, the same procedure should be adhered to in relation to other instructions and special risk factors for banks on the watch list or subject to stricter supervision.

60. It would also be appropriate if the bank's external auditors were required to account for the bank's compliance with instructions unlike today, where auditors need only include comments in the audit book entry if an instruction has not been complied with.

C. Reporting

61. The FSA's executive management organizes its usual supervisory activities independently of the Ministry of Economic and Business Affairs. This means that the ministry cannot issue instructions on supervisory matters.

62. A procedure established by the FSA lays down guidelines for reporting to the supervisory and executive boards of a bank. Oral and written FSA inspection reports are prepared.

63. The FSA holds a meeting attended by the company's supervisory board, executive board and external auditors. At the meeting, the FSA outlines the conclusions of the inspection, that is, reprimands, instructions and risk factors. The materiality of the conclusions determines the priority given to instructions and risk factors.

Administrative fines are applied by several other European countries, including Sweden, Germany and the UK. In Sweden, administrative fines are used for non-registration or delayed registration of enterprises.

64. The FSA has stated that the inspection manager and possibly the head of division participate in the oral report given to the bank on completion of ordinary and limited inspections. In future, the FSA will increasingly include its executive management in the reporting to banks. In 2008, the FSA's executive management participated in three out of four meetings with the executive and supervisory boards of category 2 banks.

65. A written report is also submitted at the end of FSA inspections. As a result of the discussions at the meeting, the written conclusions may be briefer than those of the oral report. Rigsrevisionen's examination has shown that the procedure does not require the order in which the conclusions in written reports are stated to reflect their materiality. The report is divided into the inspection areas within which reprimands, instructions and risk factors may occur.

Cases of major political significance

66. The FSA has an obligation to inform the ministry if a case is considered to be "of major political significance". If considered of interest to the general public (the subject of media coverage) or the Folketing, the issue may have major political significance.

67. In situations in which FSA activities vis-à-vis a bank go beyond the supervisory activities usually performed, the FSA must obtain authorization from the Ministry of Economic and Business Affairs. An example of such an activity might be arranging contact with other financial services companies in connection with a possible takeover, a practice that originates in an agreement from 1998.

Assessment

68. The final reporting to the banks does not distinguish clearly between critical and less critical situations. This is a particular problem when several of a bank's business areas are being investigated because a large number of reprimands, instructions and risk factors may be involved.

IV. FSA supervision of Roskilde Bank A/S

MAIN CONCLUSION

The FSA has supervised Roskilde Bank A/S according to its guidelines, including those governing the supervision of banks subject to stricter supervision. However, the FSA failed to fully maintain its estimates of the bank's capital adequacy need and follow up systematically on instructions and risk factors. Rigsrevisionen finds that on the basis of its knowledge of Roskilde Bank A/S' circumstances, the FSA ought to have intensified its follow-up.

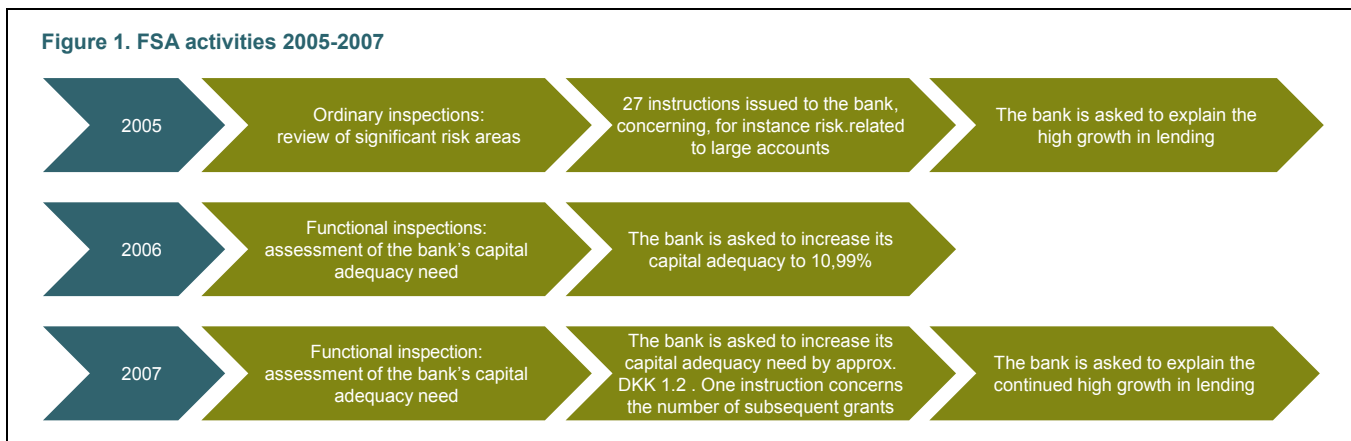
69. Rigsrevisionen has examined the FSA's supervision of Roskilde Bank A/S, how it applied the instruments available for the supervision and how the outcome of the supervision was reported to Roskilde Bank A/S.

70. Rigsrevisionen has examined the FSA's activities in relation to Roskilde Bank A/S for the period 2005-2008. Based on the FSA's rating, Roskilde Bank A/S had been subject to stricter supervision since 2006. In 2005, the rating was 4.

FSA activities relating to Roskilde Bank A/S

71. The FSA carried out an ordinary inspection of the bank in 2005 and a functional inspection of the bank's capital adequacy need in 2006 and 2007, in compliance with the FSA guidelines on the supervision of banks, including those subject to stricter supervision. According to the Authority's internal procedures, an ordinary inspection of Roskilde Bank A/S was to be performed in the autumn of 2008.

Figure 1 outlines FSA inspection activities in Roskilde Bank A/S during the period 2005-2007.



72. In February and March 2005, the Authority carried out an ordinary inspection of Roskilde Bank A/S in which all accounts in excess of DKK 40m were reviewed and small loans spot-checked. The review did not give rise to special comment, and the inspection resulted in the issue of 27 instructions to Roskilde Bank A/S, and a further instruction subsequently. As mentioned earlier, the FSA established a procedure in 2006 that distinguishes between more critical, critical and less critical instructions. According to the procedure, 13 out of the 28 instructions were characterized as critical and concerned good practice, company management and company organization rules. The 13 critical instructions included instructions to adjust write-downs and for the supervisory board to lay down and approve the credit policy. In addition, a number of risk factors were pointed out to the bank, including growth in lending, industry focus (heavy exposure to real property financing) and the number of very large accounts.

73. In 2005, the FSA also examined the growth in lending of all banks based on their end-June reports. The examination showed that Roskilde Bank A/S had a significantly higher growth in lending than other Danish banks, i.e., an increase of 46.1% from 2004 to 2005. This compared with an average growth for all banks of 21.6%. In view of this, the FSA asked Roskilde Bank A/S to explain the high growth in lending.

74. In October 2006, the FSA reviewed the bank's calculation of capital adequacy need in connection with a review of the bank's 32 largest accounts. The review showed that some accounts were so weak that an increase of DKK 1.2bn in capital adequacy need was required to counter the credit risk.

With 8% as the basis (the statutory minimum capital adequacy requirement), this amount equalled an extra 3.69%, or a capital adequacy need of 11.69%. After adjustments relating to capital procurement, consolidation, interest-rate risk, currency risk and liquidity, the bank's overall capital adequacy need amounted to 10.99%.

The provision model applied in this case focuses specifically on the bank's risk profile in the credit area.

According to the Authority's rating model, the bank's capital adequacy need amounted to 11.87%.

75. In November 2006, the bank increased its capital adequacy need to 10.75%. According to the FSA, this happened at a time when the bank knew the Authority was likely to fix a capital adequacy requirement. At its meeting in December 2006, on the basis of the FSA's recommendation to approve the bank's calculation, the Financial Services Council found no reason to change the capital adequacy need. The FSA justifies its recommendation by the uncertainty attaching to the calculation methods.

76. The outcome of the FSA's inspection caused the Authority notify the bank of several risk factors, including the bank's procedure for granting loans and the lack of credit office resources. The FSA made no comments on liquidity – regardless of the bank's urgent need for cash funds. The FSA has stated that it did not call the bank's attention to the risk factor relating to the rules on adequate liquidity, because it considered the bank management to be fully aware of the problem.

77. In December 2007, the FSA re-examined the bank's capital adequacy need by reviewing the 33 largest accounts. The review showed that some of the accounts were so weak that in order to counter the credit risk, the capital adequacy need had to be increased by DKK 1.2bn. With 8% as the basis, the amount less write-downs equalled an additional 2.33%, or a total capital adequacy need of 10.33%. According to the Authority's rating model, the bank's capital adequacy need amounted to 8.35% only.

78. After the examination, in January 2008 the bank increased its capital adequacy need to 10.48%. With reference to the uncertainty attaching to the calculation methods, the FSA found no reason to change the bank's calculation of the capital adequacy need. As a result of the examination, the bank received six instructions (all critical) and one reprimand. It was also notified of several risk factors, including its procedure for granting loans and the lack of credit office resources. The FSA has stated that three of the instructions concerned requirements stipulated by the Danish Executive Order on the Preparation of Financial Statements. One instruction concerning subsequent grants reflected the bank's failure to take the initiative to change the procedure. As in 2006, the FSA made no comments on liquidity – regardless of the bank's urgent need for cash funds. The FSA has stated that it did not call the bank's attention to the risk factor concerning the rules on adequate liquidity, because it considered the bank to have a sufficiently high excess cover.

79. In 2007, the FSA re-examined the growth in lending of all banks. The examination showed that Roskilde Bank A/S had recorded a 51% growth in lending during the period 2006-2007. During the same period, the average growth for all banks amounted to 24%. The FSA again asked the bank to explain the high growth in lending.

80. Thus, in 2005, Roskilde Bank A/S received 28 instructions (of which 13 were critical) and 2 reprimands and was notified of 11 risk factors. In 2008, the bank received 16 instructions (of which 14 were critical and 2 more critical) and 2 reprimands, and was notified of 3 risk factors. By comparison, the FSA has stated that the average number of instructions issued to banks range from approx. 11 to 14, and that more critical instructions are rare. However, this information relates to the period 2006-2008. The FSA applied no other instruments, for example, the dismissal of supervisory board members or the CEO, vis-à-vis Roskilde Bank A/S.

81. The review of the accounts of a bank is an important element of FSA inspections. Rigsrevisionen therefore reviewed the Authority's major inspections in 2005, 2006 and 2007. Moreover, Rigsrevisionen carried out a special review of the major loans (accounts) that formed part of the 2005 examination.

Following its review at the FSA, Rigsrevisionen established that the Authority could not readily explain the calculation assumptions on which value computations were based – prices per square metre, for example. Basically, the difference between the bank's and the Authority's (usually lower) valuation should be included in the capital adequacy need or should be applied for write-downs, subject to the existence of objective criteria, see the accounting rules. The FSA has stated that the valuation is partly based on estimates. The FSA has no procedures to determine when inspectors can accept a minor deviation and thus do not correct the bank's computations.

Follow-up on instructions issued to Roskilde Bank A/S

82. Each year, the FSA has examined Roskilde Bank A/S' annual report and audit book entries as part of the regular supervision. Under the Danish Executive Order on the Preparation of Financial Statements, auditors must give details in the audit book entry about instructions not complied with. According to the FSA, the bank's internal auditors stated that the audits performed in the period 2005-2007 did not give rise to comments in any year. Furthermore, the FSA has stated that the bank's external auditors made no comments about the FSA instructions and that each year, the auditors attached an unqualified audit opinion to the financial statements.

83. During the period 2005-2007, Roskilde Bank A/S received a total of 41 instructions, of which the FSA followed up on 13 more critical instructions at its own initiative, see the FSA's 2006 procedures. In the remaining cases, the FSA assumed that the external auditors followed up on the bank's compliance with the instructions because the auditor would otherwise have to disclose any non-compliance with instructions. The FSA has been unable to state whether Roskilde Bank A/S complied with all instructions issued.

84. In relation to any failure on the part of the auditors to follow up, the FSA is investigating whether the internal and external auditors have discharged their duties properly in relation to Roskilde Bank A/S. Rigsrevisionen believes there are good reasons for the FSA to look into the work of the auditors through an inspection.

Significance of changed accounting rules for Roskilde Bank A/S

85. In January 2005, changed accounting rules were introduced which meant that, unlike existing practice, banks, including Roskilde Bank A/S, could no longer make provisions for probable losses. The changed international accounting rules, IFRS enable banks to write down accounts for which objective impairment indications exist. These indications are discretionary, made by the bank and audited by the external auditors. On the basis of the financial statements, the tax profit or loss is computed by means of a number of tax adjustments. The changed accounting rules thus have no immediate consequences for the tax profit or loss.

86. In January 2007, new capital adequacy rules (Basel II) were introduced. According to these rules, banks must calculate their individual capital adequacy needs by reviewing all risks and assessing the amount of capital they need in addition to the statutory 8% capital adequacy requirement. According to the Danish Executive Order on Capital Adequacy, in determining their capital adequacy needs, banks must assess their capital needs on the basis of a number of different risks, including market risks, liquidity risks and credit risks.

87. The short-term implications of the adjustment of the changed accounting rules appears from Roskilde Bank A/S' 2005 annual report. However, the long-term significance of the changed accounting and capital adequacy rules for the extent of write-downs on loans and capital adequacy in Roskilde Bank A/S cannot be determined precisely, as it cannot be assessed how the bank would have acted had the previous rules providing greater scope for action remained in force.

88. According to Nationalbanken's half-year report on financial stability in 2008, Danish banks have made fewer provisions for losses in past years in per cent of lending and guarantees. Also, the reduction in these loss buffers has made banks more sensitive to increasing losses. Furthermore, Nationalbanken states that the buffer reductions may reflect the banks' belief that their accounts are subject to lower risk than in the past. They are probably also a result of the change in ground rules for bank buffers following the introduction of changed accounting rules on 1 January 2005 and new capital adequacy rules (Basel II) on 1 January 2007.

Statement from Roskilde Bank A/S' former auditor

89. External information is used in connection with the FSA's rating of banks. Therefore, Rigsrevisionen asked the FSA to account for the way in which it had followed up on the statement submitted in 1997 to Roskilde Bank A/S by its former auditor.

90. The FSA has stated that it received a statement from the bank on 10 March 1998 and subsequently a substantial amount of material from the bank's deputy chairman at the time. The material included a copy of a presentation by the bank's former auditor at a meeting in February 1997 attended by the chairman and deputy chairman of the supervisory board and the CEO. The FSA included this material in its organization of the supervision, and in July 1998, the Authority concluded that there was no reason to take any further action. According to the FSA, the inspection of the bank carried out in 1999 included the relevant elements. The FSA finds it had no reason to go further into the proceedings relating to the interaction between the bank's executive and supervisory boards and the conflict that the former auditor had been called in to mediate. The FSA points out that according to the information provided in the minutes of the board meetings, the issue had been closed.

Market risk is the risk that market price fluctuations (interest rates, exchange rates or share prices) generate losses.

Credit risk is the risk of suffering a loss if a counterparty defaults on its payment obligations.

Assessment

91. During the period 2005-2007, the FSA carried out annual inspections of Roskilde Bank A/S, which is in accordance with the inspection frequency for banks, including those subject to stricter supervision. Roskilde Bank A/S has been subject to stricter supervision since 2006.

92. The problems at Roskilde Bank A/S came as no surprise to the FSA. The FSA highlighted procedural problems as early as 2005, advising the bank of a number of risks, including its growth in lending, industry focus and share in major accounts.

93. The only instruments applied by the FSA in relation to Roskilde Bank A/S were instructions and risk factors.

94. In neither 2006 nor 2007 did the FSA maintain its estimate of the bank's capital adequacy need.

95. The FSA ought to improve the model used to determine real property values and establish procedures for the timing of adjusting capital adequacy needs or write-downs. These developments are necessary to provide uniform FSA decisions.

96. The FSA knew of the problems at Roskilde Bank A/S, but failed to follow up on compliance with instructions. The FSA ought to have actively monitored developments in the issues concerned and refrained from relying on the executive order on bank audits, according to which auditors are required to check that FSA instructions are complied with.

97. In the period 2005-2007, Roskilde Bank A/S' external auditors made no comments about non-compliance with instructions. The FSA has been unable to inform Rigsrevisionen of whether all instructions issued to Roskilde Bank A/S have been complied with. As regards the possible lack of follow-up on the part of the auditors, the FSA is investigating whether the internal and external auditors discharged their duties properly in relation to Roskilde Bank A/S. Rigsrevisionen believes there are good reasons for the FSA to look into the auditors' performance.

98. In January 2005, accounting rules were changed to the effect that banks could no longer make provisions for probable losses. Rigsrevisionen is unable to establish the significance of the changed accounting rules for the amount of write-downs on loans in Roskilde Bank A/S, because it is impossible to estimate how the bank would have acted under the previous accounting rules. Nationalbanken notes that over the past few years, Danish banks have generally built up lower loss buffers, which may partly be due to the changed accounting rules in combination with the changed capital adequacy rules.

99. The FSA has included the relevant management aspects and viewpoints put forward in 1996 by the former bank auditor. However, these did not prompt the FSA to carry out a special investigation of the bank management.

V. Measures taken in relation to Roskilde Bank A/S

MAIN CONCLUSION

The two measures taken in relation to Roskilde Bank A/S were developed ad-hoc, implemented on the basis of a number of assumptions made by the Ministry of Economic and Business Affairs and established under extreme time constraints. In the course of the investigation, the Ministry of Economic and Business Affairs procured the necessary statutory authority to leave the actual winding-up of Roskilde Bank A/S to the central government winding-up company (the Financial Stability Company).

100. Rigsrevisionen has examined whether the measures taken in relation to Roskilde Bank A/S were organized and implemented appropriately, because Appropriation 199 4/9 2008 on liquidity support was later supplemented by Appropriation 25 27/11 2008 on the winding-up of Roskilde Bank A/S. Similarly, in Rigsrevisionen's opinion, the implementation of the measures should be viewed in relation to the setting up of the Financial Stability Company.

A. The Ministry of Economic and Business Affairs' deliberations concerning the type of measures to be taken

101. The Ministry of Economic and Business Affairs has stated that its deliberations concerning which measures to take in relation to Roskilde Bank A/S were largely based on the principles and experience used to handle the bank crisis in the 1990s. The ministry has stated that the most recent example of a major bank in distress was Varde Bank in 1993. These are rare situations that have been handled on a "case-by-case" basis. In addition to the experience from the 1990s, the ministry also took into account the difficult and uncertain situation that has characterized international capital markets since 2007. Common features of the measures chosen – both in terms of the original liquidity support and the subsequent takeover of Roskilde Bank A/S – were that:

- financial stability had to be secured
- the government/Nationalbanken was only to intervene if absolutely necessary and no private solutions could be found
- private sector contributions were required
- government support was not to cover share capital and other risk capital
- any government risk of losses in general was to be limited to a minimum
- the measures had to be compatible with the state-aid rules of the EU Treaty.

102. In connection with the consultation procedure for the Financial Stability Act, in a statement dated 17 October 2008, the European Central Bank pointed out that supporting temporarily illiquid but solvent banks is a task for central banks, whereas it is incompatible with the ban against monetary financing for a central bank to support insolvent banks.

The following paragraphs will assess the organization and implementation of the liquidity support and the subsequent takeover of Roskilde Bank A/S relative to the above principles.

Liquidity support for Roskilde Bank A/S

103. At the beginning of July 2008, Roskilde Bank A/S announced that it was solvent but that significant write-downs of the order of DKK 550m made when the interim report was announced might result in a run on the bank. Therefore, the FSA was authorized to conduct discussions with several banks with a view to obtaining a private solution to the liquidity problems. Shortly afterwards, however, it became clear that there were no interested buyers, and the Danish Bankers' Association stated that the sector was unable to provide the necessary funds to Roskilde Bank A/S.

104. In the ministry's opinion, a run on Roskilde Bank A/S could create uncertainty about refinancing the foreign borrowing of all Danish banks. Following discussions with the Ministry of Economic and Business Affairs, the FSA and the Danish Bankers' Association, Nationalbanken granted a loan to Roskilde Bank A/S. To ensure private contributions to the solution, the Private Contingency Association was to provide a DKK 750m guarantee. The government was to provide a supplementary guarantee to cover over and above the said amount.

The Private Contingency Association is a voluntary scheme and bank payments to the association are voluntary. The Private Contingency Association's assets consist of member guarantees issued to the association for DKK 750m per calendar year. However, subject to unanimous decision, the association's committee of representatives may decide to provide further deposits of up to DKK 750m.

The ministry has explained that it was difficult to estimate exactly the drain on Nationalbanken's loan facility. The ministry believes it was important to signal unlimited drawing rights with Nationalbanken to avoid speculations about suspension of payments. To avoid setting a precedent and banks in a similar situation expecting that they would receive a governmental safety net, the commitment was made conditional on efforts to dispose of Roskilde Bank A/S. The ministry also finds that government intervention was necessary because a possible suspension of payments would have had a substantial adverse effect on confidence in the Danish financial system. At the time, the ministry also found that the government's risk of loss was reasonably covered by the DKK 750m guarantee issued by the Private Contingency Association.

105. The examination showed that no calculation exists as to the amount of private support (DKK 750m) needed. The support granted reflects the negotiations conducted between Nationalbanken and the Private Contingency Association, in which the Ministry of Economic and Business Affairs also participated.

106. The examination also showed that Nationalbanken did not test the option of doubling the support, an option made possible by the association's by-laws. The ministry has stated that this was because approval from all association members could not be obtained within the time limit. Nor did Nationalbanken test the option of incorporating next year's deposits. In this connection, the ministry has stated that according to the guidelines on rescue aid, such aid may last for no longer than six months. Consequently, in the ministry's opinion, it was not possible in July 2008 to negotiate with the Private Contingency Association about next year's deposits.

Takeover of Roskilde Bank A/S

107. Towards the end of August 2008, it was evident that Roskilde Bank A/S no longer fulfilled the capital adequacy requirements under the Financial Services Act and that the procedure initiated had not resulted in a sale of the bank.

In the ministry's opinion, the collapse of Roskilde Bank A/S would seriously affect the Danish banks that depend on being able to fund themselves in international markets. A quick solution was needed, and Nationalbanken was in a position to take over Roskilde Bank A/S, whereas a solution involving the government would require legislation. At the time, the ministry and Nationalbanken believed the only viable solution was to set up a winding-up company (a bank) to take over Roskilde Bank A/S.

108. The ministry and Nationalbanken then suggested a solution in which Nationalbanken took over Roskilde Bank A/S, re-emphasizing the desirability of private sector contribution. This was to be secured by converting the Private Contingency Association's existing DKK 750m loss guarantee to an actual capital injection – and thus a more risky investment – in connection with setting up Bankaktieselskabet af 24. august 2008. Nationalbanken's capital injection was not intended to cover the risk-bearing capital resources. Accordingly, Roskilde Bank A/S' share capital, hybrid core capital and subordinated loan capital were basically lost. To safeguard the new bank's compliance with the statutory capital requirements, Nationalbanken was to inject share capital and subordinated loan capital. The total capital injection amounted to DKK 3.7bn, see Appropriation 25 4/11 2008.

109. The ministry has stated that the new state guarantee in connection with Nationalbanken's takeover of Roskilde Bank A/S will increase the risk of the government suffering a loss. To ensure proper winding-up and protection of public funds, the new bank's supervisory board was to consist of four members appointed by Nationalbanken and two members appointed by the Private Contingency Association.

110. The ministry subsequently stated that on 24 August 2008, it had no knowledge of the European Central Bank's strict interpretation of the monetary financing rules relative to insolvent banks given that Nationalbanken's risk was to be covered by a state guarantee.

111. The establishment of the Financial Stability Company on 13 October 2008, provided a more permanent structure for handling distressed banks. The Financial Stability Company, whose purpose is to protect and cover claims from depositors and other simple creditors in the banks and branches that are part of the Private Contingency Association, is owned by the Danish state through the Ministry of Economic and Business Affairs. In the opinion of the Ministry of Economic and Business Affairs it was not possible at the time to transfer Roskilde Bank A/S to the Financial Stability Company because such a transfer would complicate the European Commission's approval. The ministry has subsequently stated that a process has been initiated to continue the winding-up of Roskilde Bank A/S through the Financial Stability Company. Act No. 338 of 1 May 2009 provided the required authority to transfer Roskilde Bank A/S.

Assessment

112. In its choice of measures to be taken, the Ministry of Economic and Business Affairs chose to balance various considerations and followed the principles set for such measures. In compliance with European Central Bank guidelines, the ministry involved Nationalbanken in the initial phase – liquidity support to Roskilde Bank A/S.

113. The Private Contingency Association's contribution of DKK 750m to the liquidity support for Roskilde Bank A/S equals the assets of the Private Contingency Association. The amount of support was negotiated by Nationalbanken, the Private Contingency Association and the Ministry of Economic and Business Affairs. No calculation of the amount of private support required thus exists.

B. The Ministry of Economic and Business Affairs' organization and implementation of the measures

114. The Ministry of Economic and Business Affairs has stated that the liquidity support to Roskilde Bank A/S and the solution involving taking over and winding-up Roskilde Bank A/S at short notice were necessary.

115. On 10 July 2008, the government charged Nationalbanken with seeking the Finance Committee's support to grant a state guarantee to cover any loss Nationalbanken might suffer on the liquidity support beyond the share covered by the banking industry.

Overall, the first measures taken consist of three elements:

- a) loan agreement dated 10 July 2008 between Nationalbanken and Roskilde Bank A/S
- b) agreement dated 10 July 2008 on a DKK 750m loss guarantee between Nationalbanken and the Private Contingency Association
- c) Appropriation no. 199 of 23 July 2008 concerning a state guarantee for any loss suffered by Nationalbanken, see Appropriation 199 4/9 2008.

116. On 31 July 2008, the European Commission approved the above-mentioned three elements as state-aid measures compatible with the state-aid rules of the EU Treaty

117. Even before the Finance Committee had completed its consideration of Appropriation 199, it became evident on 22 August 2008 that further write-downs in Roskilde Bank A/S had to be made, after which the bank would fulfil neither the calculated capital adequacy need nor the capital adequacy requirement of the Financial Services Act. Therefore, a new solution to the bank's situation had to be found. Because the European Commission had already approved the three elements of the first package and the initial two had been instigated, the ministry was of the opinion that Appropriation 199 had to be maintained although it was evident that yet another appropriation had to be submitted. The chairman of the Finance Committee was informed of this in a letter from the minister on 29 August 2008.

Overall, the second set of measures consists of three elements:

- a) agreement dated 24 August 2008 between Nationalbanken and the Private Contingency Association about the establishment of Bankaktieselskabet af 24. august 2008
- b) agreement dated 24 August 2008 between Roskilde Bank A/S, Nationalbanken and the Private Contingency Association about the transfer of assets and liabilities
- c) Appropriation No. 25 of 4 November 2008 concerning state guarantee for any loss suffered by Nationalbanken, see Appropriation 25 27/11 2008.

118. Following the approval of Appropriation 25, a demand was made to withdraw the bank's banking licence, after which the bank would no longer act in a competitive market. On 6 October 2008, Roskilde Bank A/S suspended payments and its banking licence was withdrawn on 8 October 2008. The bank is expected to be wound up in the course of the next two years. The ministry has stated that the winding-up of Roskilde Bank A/S is delayed.

119. The Ministry of Economic and Business Affairs has stated that the only solution was a model involving the government, because the sales process initiated in July 2008 had provided no private purchasers before expiry of the time limit on 22 August 2008. Alternatively, Roskilde Bank A/S had to be declared bankrupt, which in the opinion of both the Ministry of Economic and Business Affairs and Nationalbanken would seriously damage financial stability. The ministry has thus accepted Nationalbanken's and the Private Contingency Association's takeover of Roskilde Bank A/S, after which Nationalbanken is responsible for the further administration and the related costs. The ministry has subsequently stated that a transfer has been initiated according to agreement with Nationalbanken, see Act No. 338 of

1 May 2009 concerning an increase in the deposit guarantee and the Financial Stability Company's takeover of institutions outside the Private Contingency Association.

120. The Ministry of Economic and Business Affairs has stated that in October 2008, the European Commission announced that it approved bank package I, including the establishment of the Financial Stability Company, but was not ready to approve the state-aid issue relating to the takeover of Roskilde Bank A/S.

The ministry also stated that to avoid casting doubt on the Danish state-aid scheme, European commission approval of the bank package had to be obtained as quickly as possible. The state-aid issue relating to the bank package was approved concurrently with the Folkeeting's adoption of the Financial Stability Act on 10 October 2008, whereas the state-aid issue relating to Roskilde Bank A/S was not approved until 6 November 2008. The ministry has stated that for this reason it was not possible to transfer Roskilde Bank A/S to the Financial Stability Company at the time the Company was set up.

Assessment

121. After the Financial Stability Company was established, the winding up of Roskilde Bank A/S continued under the auspices of Nationalbanken. Rigsrevisionen finds that in the circumstances, Nationalbanken could be brought in as a temporary player. Rigsrevisionen notes that in the course of the investigation, the Ministry of Economic and Business Affairs procured the necessary statutory authority to leave the actual winding-up of Roskilde Bank A/S to the central government winding-up company. Rigsrevisionen finds that there are good reasons for the Ministry of Economic and Business Affairs' initiative to procure statutory authority for the transfer of Roskilde Bank A/S.

C. The Ministry of Economic and Business Affairs' follow-up on the measures taken

122. According to Appropriation No. 199, Nationalbanken was to regularly notify the Minister for Economic and Business Affairs in her capacity of Royal Bank Commissioner of the status of withdrawals from the state guarantee. Furthermore, the Finance Committee was to be notified in continuation hereof.

Nationalbanken has forwarded weekly summaries of its account with Roskilde Bank A/S. Withdrawals from the loan facility grew from approx. DKK 1.2bn on 25 July 2008 to approx. DKK 4.4bn on 29 August 2008. The ministry has stated that on 21 August 2008, during consultations, the minister informed the Finance Committee of the withdrawal from the loan facility. The ministry's explanation for the lack of notification is that the Appropriation was not adopted until the beginning of September. Rigsrevisionen notes that the withdrawal turned out to be significantly lower than the estimated approx. DKK 15-20bn in Appropriation 199. However, such withdrawal should be viewed in the light of the fact that at the time, the liquidity facility was expected to run for six months.

Assessment

123. Appropriation No. 199 was adopted on 4 September 2008. Before the adoption, more than DKK 4bn was drawn on the credit facility with Nationalbanken. Rigsrevisionen notes that the Ministry of Economic and Business Affairs informed the Finance Committee of the drain on the credit facility at the committee consultation in August 2008.

VI. Framework for the FSA activities

MAIN CONCLUSION

The FSA has had sufficient financial resources but difficulties in attracting and retaining staff, including credit specialists. The FSA's confidentiality rules have been changed to the effect that in future, the public will be able to learn more about the financial position of financial services companies.

124. In this chapter, Rigsrevisionen examines the FSA's financial and human resources and the Authority's duty of confidentiality.

A. Financial and human resources

125. The appropriation for the FSA is covered by the charges payable by the enterprises that are subject to FSA supervision. Each year, the FSA fixes the charges pursuant to the related provisions of the Financial Services Act. This revenue is collected at the end of the fiscal year and the government therefore makes liquidity available on a current basis for the FSA's operations. Like most government institutions, the FSA has been subject to the Danish Ministry of Finance's general 2% efficiency requirement.

126. The Ministry of Economic and Business Affairs has stated that it considers the FSA's financial resources to be sufficient. Over the years the FSA has accumulated a pay bill surplus which reflects the Authority's human resource situation with several vacancies.

The FSA's staff requirements have been increasing since 2005. Table 3 shows this development.

Table 3. Staff requirements and wastage (full-time equivalent (FTE)) (Number)

	2005	2006	2007	2008
Staff (FSA)	174	182	188	190
Wastage (FSA)	28	35	49	39
Wastage as a percentage of FTE (FSA)	16 %	19 %	26 %	21 %
Wastage as a percentage of FTE (government in general)	12 %	13 %	16 %	15 %

Source: ISOLA.

Table 3 also shows that during the period 2005-2008, the Authority's staff turnover was between 16% and 21%, and was 26% in 2007. As for the government in general, staff turnover during the same period was lower – and in 2007 in particular, staff turnover in the FSA was considerably higher.

127. The FSA has stated that the reason for the relatively high staff turnover in 2007 in particular was the direct recruitment of FSA staff, especially senior bank staff, by the banks. The examination showed that the FSA subsequently readvertised the vacancies.

128. Above all, implementing inspections requires a sufficient number of inspection managers. Rigsrevisionen's examination showed that the number of inspection managers in the FSA's bank office dropped from 10 to 6 during the period 2005-2008. The FSA has stated that this is in itself a problem, but that the relatively high staff turnover among senior bank staff is even more challenging because the recruitment basis for inspection managers is eliminated.

However, the FSA has stated that this has not affected implementation of the planned inspection programme, because the FSA is able to reorder priorities in order to be able to implement the inspection programme.

129. In connection with bank package I, extra resources were contributed to the FSA to set up a specialist unit with particular focus on the credit area. The FSA estimates that the extra resources will enable it to recruit certain specialist staff it would otherwise have had difficulty in attracting: credit specialists, auditors (MSc's in Business Administration and Auditing) and actuaries. Bank package II caused the FSA to reorganize its bank supervision area.

130. As a result of the high staff turnover, general salary levels were discussed in 2007. These discussions led to a revision of the FSA's human resource policy, one aim being to make competence bonuses more transparent.

131. The FSA has stated that it wishes to increase general FSA salary levels. A survey conducted in spring 2009 showed that the Authority's salary levels are significantly above the ministerial average.

Assessment

132. The appropriation relating to the FSA is covered by charges paid by the enterprises that the FSA supervises. Although the FSA's appropriation has been sufficient, the FSA has been unable to utilize it and thus accumulated a pay bill surplus over the years.

133. Recent years' staff turnover at the FSA has exceeded the government average, but vacancies have continuously been re-filled. However, the FSA has had problems attracting certain types of specialists, and the group of inspection managers has been reduced, which has increased the FSA's vulnerability in terms of implementing supervisory activities.

B. The FSA's duty of confidentiality

134. Rigsrevisionen has examined the scope of the duty of confidentiality and how the FSA can inform the public of various risks, for example, credit risks, market risks and liquidity risks. For the purpose of the examination, Rigsrevisionen has reviewed the most recent amendments of the Financial Services Act.

135. The FSA is subject to special statutory confidentiality which means that it may only pass on limited information and comment on specific cases. The duty of confidentiality is intended to ensure that the following interests are safeguarded:

- protection of the business affairs of enterprises subject to supervision so that information disclosed cannot be abused for competition purposes
- assurance that information about customers of enterprises subject to supervision is not widely publicized
- promotion of supervisory effectiveness, because the FSA is considered to be able to collect the information desired more easily if enterprises are confident that such information is not passed on.

136. The FSA's confidentiality rules were relaxed by Act No. 515 of 17 June 2008, which introduced greater openness about the Financial Services Council and the FSA's work in general. The changes meant, in part, that the names of those involved in Financial Services Council decisions in principle had to be disclosed. In addition, new rules governing the decisions of the Danish Securities Council were introduced.

Legislative amendments and agreements

137. In order to improve the handling of crises in financial services companies, the Minister for Economic and Business Affairs has tabled a bill to amend the Financial Services Act in the Danish parliamentary year 2008/2009. The bill aims to relax the FSA's duty of confidentiality towards the standing committees of the Folketing and ensure greater openness about government involvement in enterprises that have gone bankrupt. The amendment appears from Act No. 133 of 24 February 2009.

138. To date, information about the general financial circumstances of a bank in difficulties could not be disclosed to the standing committees of the Danish Folketing until the government had provided a guarantee and the enterprise had suspended payments or was subject to bankruptcy proceedings. In practice, it has turned out impractical for an enterprise in difficulties to have suspended payments or to be subject to bankruptcy proceedings at the time government funds are expected to be made available as part of the solution. In future, in order to ensure that the Finance Committee's decisions can be made on an adequate and appropriate basis, the FSA will be authorized to disclose confidential information to standing committees. The right of disclosure in these situations remains limited to the general financial circumstances of a financial services company which, according to the legislative history, means that customer information is not included.

139. In some cases, once a financial services company has gone bankrupt, the government will have made funds available or provided a loss guarantee, for example, to Nationalbanken. In these cases, public interest in being informed about the background of the case is considerable. The act includes a provision that the FSA has a duty to prepare and subsequently publish a statement explaining the events leading up to the bankruptcy – including details about the role played by the FSA in relation to the enterprise.

To ensure the best possible access to information and openness, the statement published may contain confidential information. However, the statement may not include details on customer relations or third parties that have been involved in a possible takeover of the distressed enterprise or have otherwise been involved in the efforts to find a solution to the enterprise's financial problems.

140. According to the political credit package agreement concluded by the government in January 2009 with the other parties of the Folketing, except the Red-Green Alliance, commercial banks and mortgage banks must in future publish their individual capital adequacy needs. The purpose is to provide the public with insight into the financial strength of these banks and at the same time enable the FSA to publish risk information in the cases where a bank does not comply with the Authority's recommendations. The agreement provides that the information, for example about high growth in lending, that has so far exclusively been disclosed to the bank management must also increasingly be disclosed to the public. The initiative should therefore also be seen as a measure to strengthen the FSA's impact because its recommendations have not had the necessary effect in all cases.

Assessment

141. The FSA confidentiality rules have been amended to enable the disclosure of confidential information to the Finance Committee in connection with handling crises in financial services companies. Furthermore, the FSA may now prepare a public statement explaining the background to the winding up of a bank and the related government involvement. Further, Rigsrevisionen notes that in future, the FSA may lay down rules governing publication of the companies' individual capital adequacy needs and any non-compliance with risk factors.

Rigsrevisionen, 11 June 2009

Henrik Otbo

/Mads Nyholm Jacobsen

Appendix 1. Questions asked by the Public Accounts Committee

1. How has the FSA carried out risk-based supervision since 1 July 2007 and what were the consequences of this approach in relation to Roskilde Bank A/S?
2. Did Roskilde Bank A/S' problems come as a surprise to the FSA, or has Roskilde Bank A/S been subject to stricter supervision in recent years?
3. Did the FSA issue instructions to Roskilde Bank A/S – and if so, what were the results?
4. To whom and when must the FSA report when it becomes aware of danger signals and problems in a bank? Was such reporting made in the case of Roskilde Bank A/S?
5. How did the FSA follow up on the statement issued in 1997 by the former auditor of Roskilde Bank A/S?
6. In 2007 why did the FSA record a just under 25% turnover in staff and how many positions in the FSA have remained vacant? Is this turnover normal, which staff groups are involved, and is the FSA in a position to recruit the required expertise?
7. What calculation basis is used for the banks' agreement with Nationalbanken that they are required to cover precisely DKK 750m through the Private Contingency Association?
8. Is confidentiality necessary, or could the FSA and/or the financial services sector provide the public with more information about various risks? Are legislative amendments in the field expected to improve reporting?
9. What significance did the tax rules on write-downs have for Roskilde Bank A/S?
10. Did the Ministry of Economic and Business Affairs follow up sufficiently on the criticism levelled in report no. 17/04 on the FSA's activities that was concluded by Rigsrevisionen's memorandum of 24 January 2008 to the PAC?

Appendix 2. Glossary

Base capital	Base capital denotes the capital base needed by financial services companies to fulfil the statutory <i>capital requirement</i> . Base capital includes <i>core capital</i> and <i>supplementary capital</i> . Supplementary capital may account for no more than half the base capital.
Capital requirement	In a credit institution, the <i>base capital</i> must amount to no less than 8% the institution's <i>risk-weighted items</i> or <i>capital adequacy need</i> if this is higher than 8%.
Core capital	Core capital includes paid-up share capital or guarantee capital and general reserves, adjusted for intangible assets.
Credit risk	Credit risk represents the risk of suffering a loss if a counterparty defaults on its payment obligations.
Market risk	Market risk denotes the risk that market price fluctuations (interest rates, exchange rates or share prices) cause a loss.
Risk-weighted items	Risk-weighted items are a measure of the total risk of loss associated with a bank's activities. This measure is arrived at by using risk-weights to calculate items entailing a credit risk, share risk, interest-rate risk, currency risk, commodity risk, operational risk and risk relating to tangible assets, etc.
Capital adequacy ratio	Capital adequacy ratio is the base capital as a percentage of risk-weighted items.
Capital adequacy need	Capital adequacy need represents the credit institution's assessment of the minimum capital adequacy ratio needed by the bank.
Supplementary capital	Supplementary capital includes subordinated debt offered as <i>base capital</i> .