DANMARKS NATIONALBANK

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Low price for protecting the mortgage credit sector against crises

Today Danmarks Nationalbank publishes a response to the consultation by the Danish FSA on the European Commission's proposal to revise the requirements for credit institutions. Danmarks Nationalbank recommends that mortgage banks are subject to the same regulation that applies to banks.

The price for ensuring that, in a crisis situation, resolution of Danish mortgage banks can take place in a manner that will not affect financial stability and the economy is modest, calculations by Danmarks Nationalbank show.

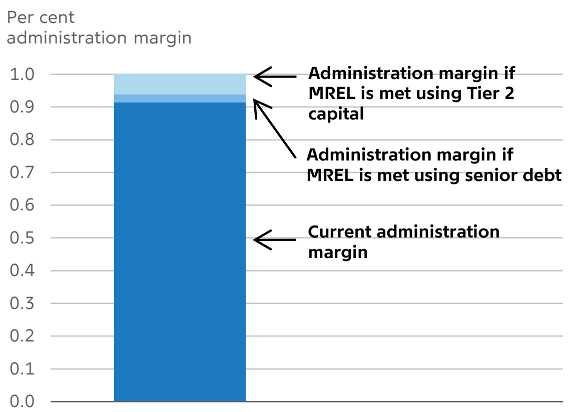
Danmarks Nationalbank has performed these calculations in order to highlight the need to apply uniform rules to the largest banks and mortgage banks so that the government and tax payers will not have to foot the bill in future crises.

According to the calculations, the costs of also introducing a minimum requirement for own funds and eligible liabilities, MREL, for mortgage banks may justify an increase in administration margins of between 0.02 and 0.11 percentage point. That is equivalent to between kr. 200 and kr. 1,100 annually per million borrowed.

Important to protect tax payers

Following the financial crisis, regulation of the financial sector has been amended to ensure that in future crises the government will not be compelled to use public funds to rescue SIFIs, i.e. the largest banks and mortgage banks. The point of departure is that, via an MREL, shareholders and creditors should to a far greater extent bear the losses, rather than the government and the tax payers. However, the Folketing (Danish parliament) has chosen to

Borrower's average administration margin after introduction of MREL Chart 1



Note: The chart shows the mortgage credit sector's average administration margin vis-à-vis households.
Source: Danmarks Nationalbank.

Chart 1
The price for ensuring that resolution of Danish mortgage institutions in a crisis situation can take place in a manner that will not affect financial stability and the economy, is modest.

exempt SIFI mortgage banks from key elements of this regulation.

A requirement that mortgage banks should hold eligible liabilities corresponding to 8 per cent of total liabilities and own funds would mean that households, firms and the economy would generally be protected if a mortgage bank were to become distressed. Such a requirement would mean that the institutions must issue eligible liabilities, which would increase their balance sheets. But on the other hand, an MREL makes it unnecessary to issue junior covered bonds and have a debt buffer.

Mortgage banks are important to society in general
Mortgage bonds play a central role in the Danish financial system, both in terms of home financing and as a liquidity instrument for banks.

The value of the mortgage bonds issued exceeds kr. 2,500 billion, and it would have considerable negative implications for financial stability and the economy if a mortgage bank were to be resolved under the rules applying at present.

Uniform rules for banks and mortgage banks would ensure that if a mortgage bank became distressed, the functions of the institution assessed to be critical to society could be continued. If an 8 per cent MREL is imposed on the institutions, it will be possible to protect mortgage bonds, even in the event of very large losses.

The framework for resolution of distressed banks is already in place, so that losses on restructuring or resolution of a bank, irrespective of its size, should primarily be borne by its owners or creditors. The European Commission's recent proposal for a revision of the Bank Recovery and Resolution Directive provides an opportunity to align the resolution rules for Danish SIFI banks and SIFI mortgage banks.

What are eligible liabilities? Box 1

Eligible liabilities are liabilities that can absorb losses in a resolution situation. The purpose of imposing an MREL on the institutions is to ensure that all the resolution tools made available by legislators can be used.

In the European Bank Recovery and Resolution Directive, BRRD, the Danish mortgage banks are exempted from having to meet a minimum requirement for own funds and eligible liabilities, MREL. However, this requires that the BRRD's resolution objectives are met in the event of insolvent liquidation of a mortgage bank.

In 2015, the legislation implementing the BRRD was passed. In that connection, the Folketing decided to make use of the option under the Directive to exempt mortgage banks from the MREL.

Due to the special rules applying to mortgage banks, the Financial Stability Company cannot use the core settlement tool of the BRRD, i.e. bail-in, for mortgage banks. Bail-in means that shareholders and creditors must bear the losses in connection with the resolution of a mortgage bank.

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