SPEECH

SPEECH BY GOVERNOR LARS ROHDE AT THE ANNUAL MEETING OF FINANCE DENMARK 2018

DANMARKS NATIONALBANK

CHECK AGAINST DELIVERY

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Thank you for inviting me to speak here today.

In an age when partnerships are discontinued, and walls are built between countries, I find it important to focus on the considerable advantages to our society and its continued development which rule-based international cooperation offers.

I have chosen to talk about three topical issues which, in their separate ways, relate to cross-border cooperation and which are essential to financial stability in Denmark. They are: anti-money laundering, crisis resolution of mortgage credit institutions and the banking union.

But first I would like to express my appreciation of the good cooperation we have had in many areas. You contributed strongly to the process of connecting the Danish krone to TARGET2-Securities. It is a great step forward that Danish banks are now able to settle securities via the single European settlement platform.

Many of you have also helped to launch Kronos2, and we have jointly achieved significant results in the Payments Council. In the FSOR, we have increased the cyber resilience of the financial sector, and we have agreed to perform sophisticated tests of the resilience of the individual institutions in the coming years – known as the red team tests.

Unfortunately, money laundering has been on everyone's lips in 2018. A simple search in Infomedia shows that the Danish word "hvidvask" has been used four times as frequently this year as in 2017.

We have witnessed extensive misuse of the financial infrastructure for illegal activities. There has been and still is a need to strengthen efforts in this area.

At Danmarks Nationalbank we are interested in this issue because money laundering can jeopardise financial stability. Customer and investor confidence is an essential prerequisite for providing financial services. So, loss of confidence can be very harmful for a bank. If confidence in a single participant is eroded, this may rapidly have an impact on the rest of the sector.

The reputation of the authorities and the country may also be severely affected. This became very clear to me at the IMF Annual Meeting in October when I received many enquiries about the money laundering challenge in the Danish financial sector.

Banks play a key role in the financial infrastructure. And with this role comes an important social responsibility. A responsibility for ensuring that their businesses are not used for illegal activities.

The number of suspicious transactions reported to the anti-money laundering secretariat has soared in recent years. If this continues, the authorities will face a huge task in relation to handling the volume of reports.

There are indications that the lines of defence are too far back. They should be reached long before reporting becomes necessary. In other words, the banks should have knowledge of their customers.

As payment systems have become faster and more efficient, it is of paramount importance that the banks have in-depth knowledge of their customers.

It is the role of the authorities to investigate cases of money laundering if there is suspicion of illegal activities. But before it comes to that, the banks have a responsibility not to engage in customer relationships if the real motives of the customers are dubious.

The political agreement to strengthen anti-money laundering efforts in Denmark that was concluded in the autumn was necessary. But money laundering knows no borders. Cross-border activities call for strengthened cross-border supervision in the EU.

So, it is essential also to enhance European cooperation. That will provide a far better overview of the activities of international banking groups. And it will also enable the build-up of stronger competences in this area.

Now I will turn my attention to another topic. Something that I have talked about previously. Resolution of mortgage credit institutions. My interest in this topic is not purely academic. I myself witnessed the near-death of a mortgage credit institution in the 90s, and I know that others who are present today shared that experience. It made an impression on me – and presumably also on you.

So, I would like to reiterate: one of the key lessons learned from the financial crisis was that it must be possible to manage crises in the financial sector without the use of government funds.

It must be possible for the large, systemically important institutions to continue in case they experience problems. They perform functions that are critical to society and essential to financial stability.

How do we ensure this? Well, one of the preconditions is that there are sufficient owner and creditor funds that can absorb losses, also known as eligible liabilities and own funds.

As you know, Danish mortgage credit institutions have been exempted from the minimum requirement for eligible liabilities and own funds, MREL. Instead, they must meet a debt buffer requirement. In Danmarks Nationalbank's opinion, that is a bad idea. And we still think so, even though things have changed since I last addressed you:

Since then, a legislative amendment has been introduced for SIFIs that include mortgage credit institutions. For them, the sum of the MREL and capital and debt buffer requirements must constitute at least 8 per cent of total liabilities and own funds.

The amendment is a step in the right direction. However, it does not solve the problem; there are still SIFIs for which the requirements are not sufficiently high for the institutions to be recapitalised and continued in a crisis situation. Furthermore, the problem with the current requirement for mortgage credit institutions is that it is not risk-sensitive.

The MREL is. It increases when risks increase, as they typically do in bad times. That is why we need an MREL for mortgage credit institutions.

And here is the good news. At Danmarks Nationalbank we have calculated the costs of introducing an MREL for mortgage credit institutions now that we have the 8 per cent requirement. And the costs are negligible.

Our calculations show that the sector's total costs will be in the range of kr. 100 to 200 million.

The institutions can finance this by reducing costs or dividend payments. If they choose to raise their administration margins instead, we have calculated that the cost is equivalent to an average increase of less than 1 basis point in administration margins.

Surely that is a low price to pay for ensuring that mortgage credit institutions can be resolved without jeopardising financial stability and taxpayer funds?

As I see it, this is the right thing to do. I would like to wake up in the morning, drink a cup of coffee and know that we make the right choices for society.

Doing away with the exemption will also give the authorities the option of using the Resolution Fund if required.

My final message regarding resolution is this: a precondition for credible resolution is that financial institutions can be handled without any knock-on effect on the sector overall.

I would like to make it clear that for Danmarks Nationalbank it is of the essence that mortgage bonds do not suffer losses. Fortunately, the Bank Recovery and Resolution Directive – BRRD – provides a solution: it is possible to exclude certain liabilities and own funds from being written down or converted. That should be the case for mortgage bonds. Instead, there must be sufficient eligible liabilities and own funds.

That is why we should have an MREL for mortgage credit institutions.

Anti-money laundering and crisis resolution rules – the two topics I have talked about so far – are examples of areas where binding international cooperation offers clear advantages.

The government envisages that next autumn a final decision will be made on Danish participation in the banking union.

What would it mean in terms of anti-money laundering and resolution of failing banks and mortgage credit institutions if Denmark joins the banking union, we might ask.

About anti-money laundering, supervision will still be a matter for the national authorities.

When it comes to crisis resolution, the single insurance element of the banking union is important, but the probability that it will be invoked is very low.

However, there are a number of other good reasons why Denmark should join the banking union.

The union has not been established for the sake of the banks but to serve the interests of citizens, firms and financial stability. And it is a further development of the single market for financial services, which strengthens competition.

For some banks, this increased competition may not be an advantage. But for citizens and firms it is a clear advantage.

The ECB's Single Supervisory Mechanism, SSM, has now existed for four years and has proved to be a strong and capable supervisory authority.

The SSM can bring together strong skills and analytical powers. This is necessary for effective supervision of the largest banks, which are complex, operate across borders and use sophisticated models.

The SSM does not necessarily give the banks more latitude. But it underpins financial stability. In this context, the parallel to anti-money laundering is also relevant. The cases we have seen illustrate that international activity requires a response in the form of close and binding international collaboration between authorities.

The greatest change if Denmark joins the banking union will be that Danish banks will be subject to the SSM supervisory practices. The impact will be most direct for the large banks, which will be supervised by the ECB via instructions to the Danish Financial Supervisory Authority. The smaller banks will still be supervised by the Danish Financial Supervisory Authority within a framework defined by the ECB.

Participation in the banking union will give Denmark a say in relation to the single supervisory practice via participation in the ECB's Supervisory Board. And via the ECB we will have a voice and influence in the Basel Committee and the Financial Stability Board, which are key bodies in the design of financial regulation.

Those who are against Danish participation in the banking union often argue that Danish taxpayers and bank customers risk footing the bill if banks in e.g. Greece or Italy fail.

At Danmarks Nationalbank we have studied this aspect closely. The heart of the matter is the joint liability of banking union participants and the likelihood that it will be invoked.

Our reply is that the structure of the banking union means that joint liability will apply only in very extreme loss scenarios. The joint liability is a kind of insurance against disaster, it will not result in regular flows of funds between banking union member states.

We are not the only ones who are concerned about ending up with bills that others ought to pay. The very structure of the banking union and the practice that has characterised the euro area member states' handling of the euro debt crisis reflect precisely these concerns.

Very large and very influential euro area players share our views and will ensure that we do not move too far in the wrong direction.

Reluctance to transfer funds between member states has been seen in connection with the crises resolved within the banking union until now. Most recently, we have seen that Italy has provided government support – but without the use of funds from other member states.

The joint liability which is already part of the banking union in the form of the Single Resolution Fund, SRF, being built up also contains protective elements. This means that a loss scenario must reach a very late stage before the SRF can be activated.

And finally, it has also been established that a single deposit insurance scheme will apply in connection with extremely large losses only. Irrespective of how this single deposit insurance scheme is designed.

This does not mean that the single insurance elements do not matter. But it means that they should not be conclusive arguments for or against Danish participation in the banking union.

Let me sum up what I have said by emphasising that rule-based international cooperation is the best solution to cross-border challenges. Not least for a small country like Denmark.

Thank you.