A Tale of Two Danish Banking Crises

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INTRODUCTION AND SUMMARY

This article compares the Danish economic crises in the years 1987-93 and 2008-10.

A significant difference between the two crises concerns external conditions. The economic crisis in recent years has been virtually global, while the Danish export markets showed sound progress during most of the period 1987-93.

Another major difference is that the economic fundamentals, in terms of the balance of payments, foreign debt, government debt and the labour market, were much stronger in the past decade than in the 1980s.

Prior overheating of the Danish economy and surging property prices occurred in both cases, whereas the fiscal-policy stance diverged. In the years immediately prior to the most recent financial crisis an accommodative fiscal policy contributed to amplifying the overheating of the economy. In the mid-1980s, on the other hand, a tight fiscal policy contributed to reducing overutilisation of production resources.

During both crises the number of failing companies in the corporate sector reached high levels, while households were more severely affected in the early 1990s than during the most recent crisis. This should be viewed in the light of the lower interest rates and unemployment in recent years compared with the early 1990s.

Both crises had a significant impact on the banking sector, while the mortgage sector got off more easily. But the two crises diverged considerably in terms of the volume of government support measures to ensure financial stability. Despite the stronger economic fundamentals, there was a greater and broader need for government support during the most recent crisis. In addition to the much faster setback, by all appearances this can be attributed to more lenient capital requirements and fewer provisions.

During both crises many of the banks that were unable to continue as independent business enterprises had recorded strong lending growth, a large share of property-related exposures and relatively many large exposures.

The crisis in 1987-93 prompted only minor adjustments to the statutory regulation of the financial system, reflecting that a minor share of the problems erupted directly from the financial sector. On the other hand, there are many indications that the amendments to financial regulation in the wake of the recent financial crisis will be much more extensive. The underlying factors are the global and systemic nature of this financial crisis as well as the massive government support measures.

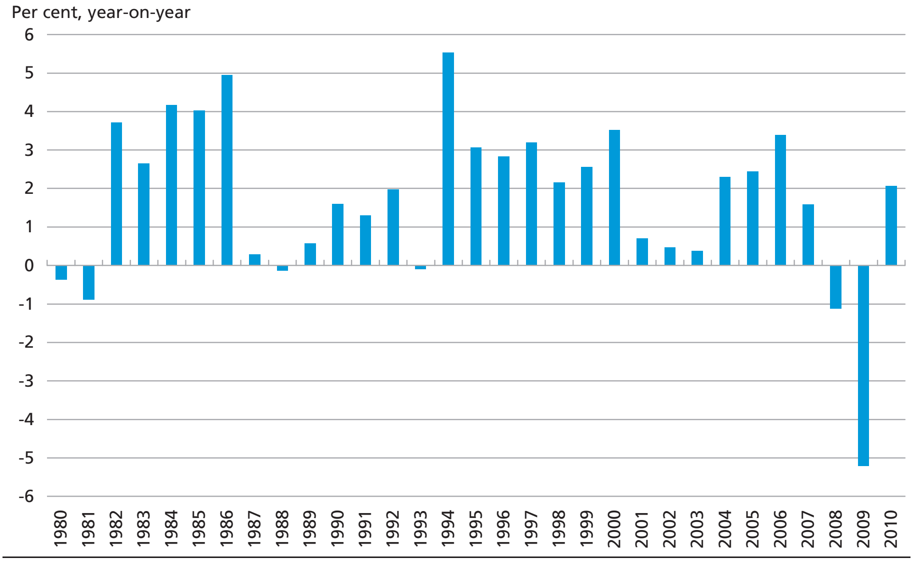
ECONOMIC BACKGROUND

In Denmark the years 1987-93 constituted an unusually long period of low growth and rising unemployment after five years of strong economic upswing and overheating of the economy, cf. Chart 1.

Assessed on the basis of the quarterly seasonally adjusted national accounts, the economic reversal set in already at the beginning of 1986, i.e. before the implementation of the package of economic austerity measures in October 1986, including tax on consumer loan interest (which was soon abolished, however) and tightening of the home-financing rules to counteract a rapidly growing current-account deficit.

The transition to a consistent fixed-exchange-rate policy in 1982 and abolition of the automatic cost-of-living adjustment reduced devaluation and inflation expectations during the 1980s and the early 1990s. But the resultant drop in interest rates also led to a strong boom. As the starting point was a highly indebted economy, large current-account

REAL GROWTH IN GDP — Chart 1



Source: Statistics Denmark.

deficits and a structurally weak labour market, there was a need for strong fiscal improvements and incentives for private savings. Though long, the required period of adjustment also provided a foundation for the subsequent strengthening of the Danish economy and confidence in the fixed-exchange-rate policy. A comprehensive tax reform reduced the taxable value of the tax relief on interest with effect from 1987, cf. Callesen et al. (2008) and Gaard and Kieler (2005). Real interest rates after tax, which had been negative from the beginning of the 1970s to the mid-1980s, now became positive. While leading to a much needed improvement of the financial incentive structure that was conducive to savings, this dampened consumption and residential investment in the short term.

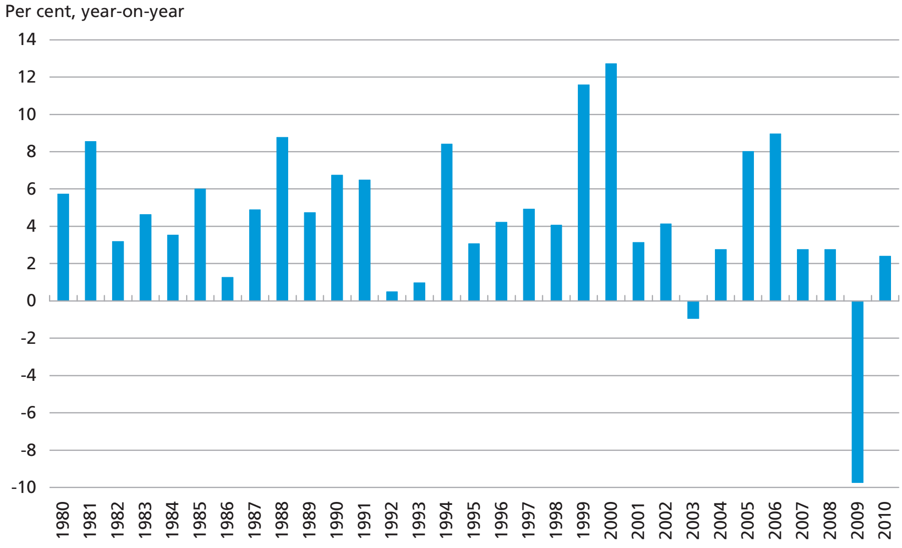
Finally, as a result of overheating of the economy in the mid-1980s, high wage increases (close to 10 per cent) were agreed in connection with the collective bargaining in 1987. This led to deterioration of competitiveness in the exporting sectors of a magnitude that prompted the government to intervene at the end of the year, restructuring the taxes paid by employers.

The low growth in the Danish economy during the 2nd half of the 1980s cannot be attributed to cyclical developments in other countries, however. The Danish export markets showed sound progress during that period, further buoyed up by high growth in Germany in the early 1990s immediately after the reunification of East and West Germany. The cyclical reversal in the European economy did not dampen Danish export growth until 1992/93, cf. Chart 2.[1]

Unlike the situation in the period 1987-93, the recession in recent years has to a high degree been founded in the global economy. During 2008 the world economy was hit by the most severe downturn in times of peace since the Great Depression in the 1930s due to a combination of macroeconomic overheating and financial markets running out of control. The crisis was triggered by the turmoil in the US financial markets as a result of the downturn in the US housing market which spread to the financial markets in Europe in the 2nd half of 2007, cf. Bech and Berg (2009). US subprime mortgages had been "repackaged" as underlying assets in different types of structured bonds and then sold to banks and investors worldwide. As the losses on such loans began to surface there was considerable uncertainty as to which banks had that type of bonds in their portfolios and were therefore at risk of incurring losses. As a consequence, banks in both the USA and Europe became reluctant

[1] The German reunification boom in the early 1990s also led to relatively high inflation by German standards, however, and thus a relatively high level of interest rates, which influenced the interest-rate level in Denmark via the fixed-exchange-rate policy.

REAL GROWTH IN EXPORTS OF GOODS AND SERVICES Chart 2



Source: Statistics Denmark.

to lend each other liquidity offered on an uncollateralised basis, resulting in a large share of trading in the money markets practically coming to a standstill. Moreover, it became clear to the financial enterprises that their total leverage and exposure had become much too high.

Initially, it was a liquidity crisis in the banking system, but in the course of 2008 it became clear that the losses of several of the world's major financial enterprises were so severe that both their solvency and the overall financial stability were at risk. In September 2008 the US authorities had to take control of the two mortgage giants, Fannie Mae and Freddie Mac, and the insurance company AIG, while the Lehman Brothers investment bank failed; global confidence in the financial system plummeting as a result. Central banks and governments worldwide had to implement a large number of support measures to prevent a meltdown of the financial system.

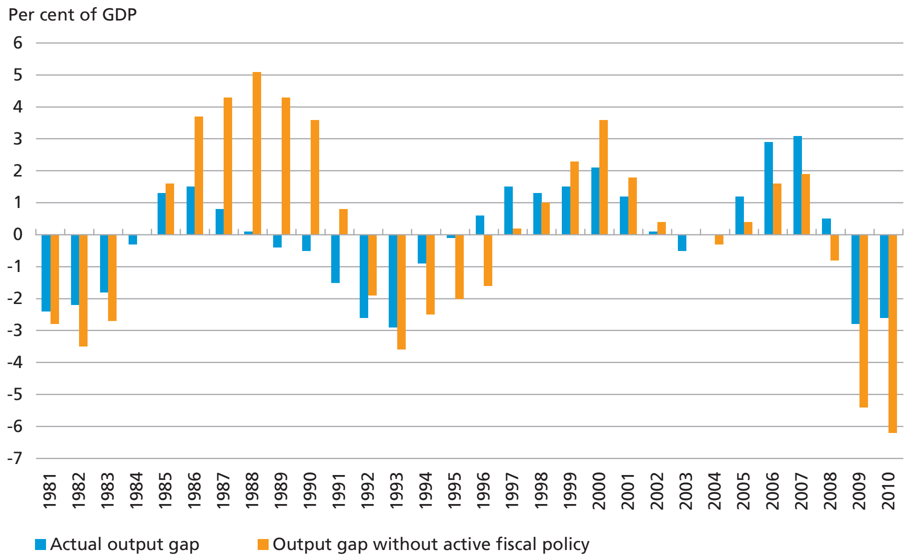
In Denmark the fall in the real gross domestic product, GDP, was approximately 5 per cent in 2009, the most rapid recession seen since the end of World War II. Growth in 2009 was about 6 percentage points lower than estimated in Danmarks Nationalbank's spring forecast from the 1st quarter of 2008. About two thirds of the unexpected large fall in real GDP in 2009 can be attributed to lower growth in the export markets, cf. Spange (2010).

The Danish economy was in a slowdown phase even before the global financial crisis really took off in 2008, however. House prices as well as quarterly seasonally adjusted real GDP fell in the 4th quarter of 2007. The reversal in the Danish economy prior to the financial crisis came after several years of economic boom and overutilisation of production resources.

The capacity pressure on the Danish economy prior to the financial crisis in 2008 can be illustrated by the "output gap" which quantifies actual real GDP in relation to potential real GDP, i.e. an estimate of the maximum output volume that will not lead to pressure on the labour market, cf. Chart 3. Measured in this way, the economy exceeded its capacity limit in the years 2005-07. An accommodative fiscal policy further amplified the overheating of the economy and the pressure on the labour market during that period. In comparison, the tight fiscal policy in the mid-1980s contributed to limiting the overheating of the economy.

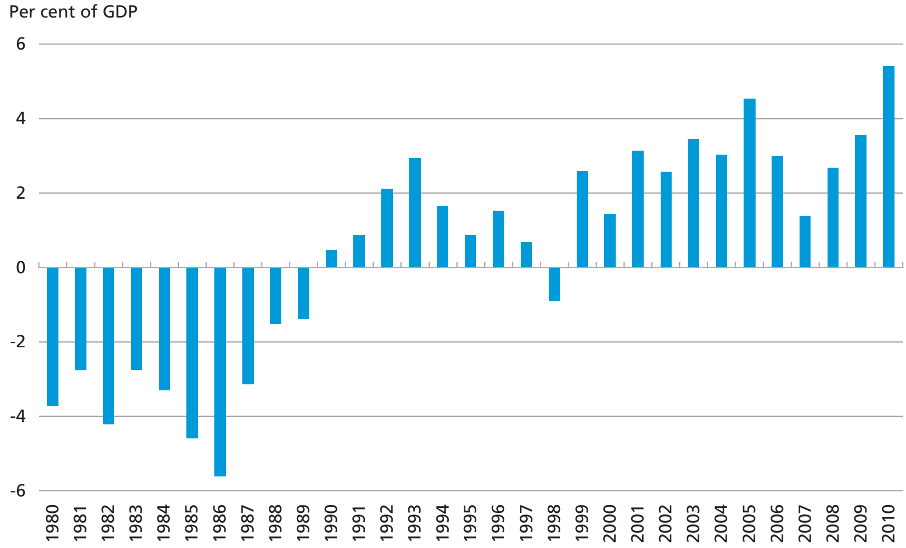
The wage competitiveness of Danish industry has gradually weakened since the mid-1990s as a result of higher growth in unit labour costs in Denmark than abroad. Nevertheless, there has been a sound current-account surplus over the last decade, cf. Chart 4. This is particularly due to strong improvement of net income from interest, partially in step with the reversal of the external debt to net external assets. It may also be attributed to high growth in Denmark's export markets, a strong increase in the value of North Sea oil and gas production and a considerable ex-

OUTPUT GAP WITH AND WITHOUT ACTIVE FISCAL POLICY Chart 3



Note: Output gap without active fiscal policy is calculated by stripping the real output gap of multi-annual fiscal effects on real GDP.
Source: Ministry of Finance and Danmarks Nationalbank.

BALANCE OF THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS Chart 4



Note: Calculated as external net lending in the national accounts.
Source: Statistics Denmark.

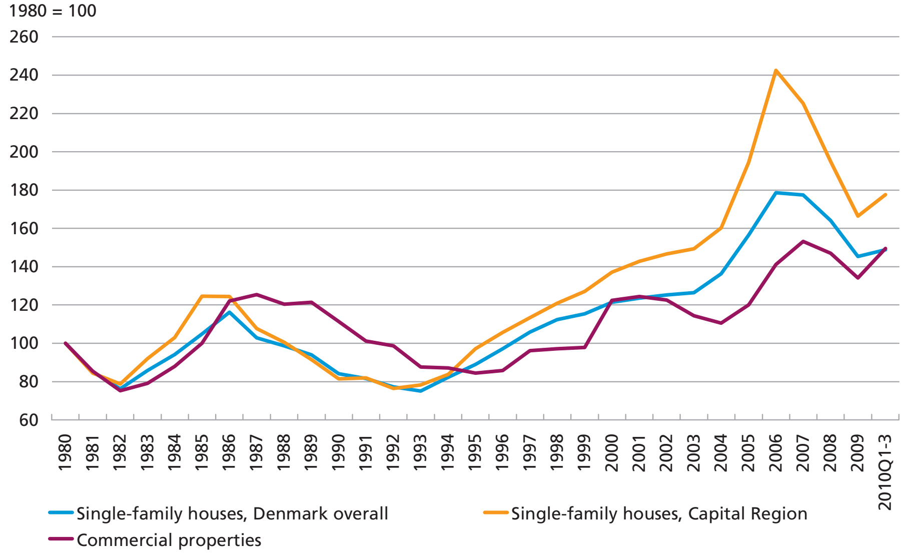
pansion of the merchant fleet. The course of the balance of payments during the most recent overheating of the economy is therefore different from the situation in the mid-1980s when contractive policy measures were implemented in response to current-account problems.

Experience in Denmark as well as other countries shows that during periods of strong economic growth, imbalances typically build up in the economy and subsequently have to be addressed, cf. Pedersen and Sørensen (2009). In the 1st half of the 1980s property prices increased substantially over a few years in relation to the development in construction costs, cf. chart 5. The years leading up to the most recent financial crisis were also characterised by soaring property prices. Part of the banks' lending is collateralised against real property, and both crises have been characterised by substantial write-downs in banks with large property-related exposures as property prices reversed. The development in house prices is analysed in more detail in Dam et al. (2011).

BANK FAILURES AND CREDIT EXPANSION

Following the many bank failures during the inter-war period, the period from the end of World War II until the early 1980s was characterised by pronounced stability in the Danish banking sector. It was also a period in which credit rationing and foreign-exchange control were central economic policy tools, cf. Abildgren (2009) and Østrup (2008).

INDEX OF PROPERTY PRICES IN RELATION TO CONSTRUCTION COSTS Chart 5



Note: The price deflator for residential investments is used as an indicator of construction costs. The price development for single-family houses in all local authority districts in the County of Copenhagen is used for the period prior to 2006 as an indicator of the price development in the Capital Region of Denmark. Experience shows that the price development for commercial properties covering strictly commercial properties should be interpreted with caution due to the relatively low number of transactions.

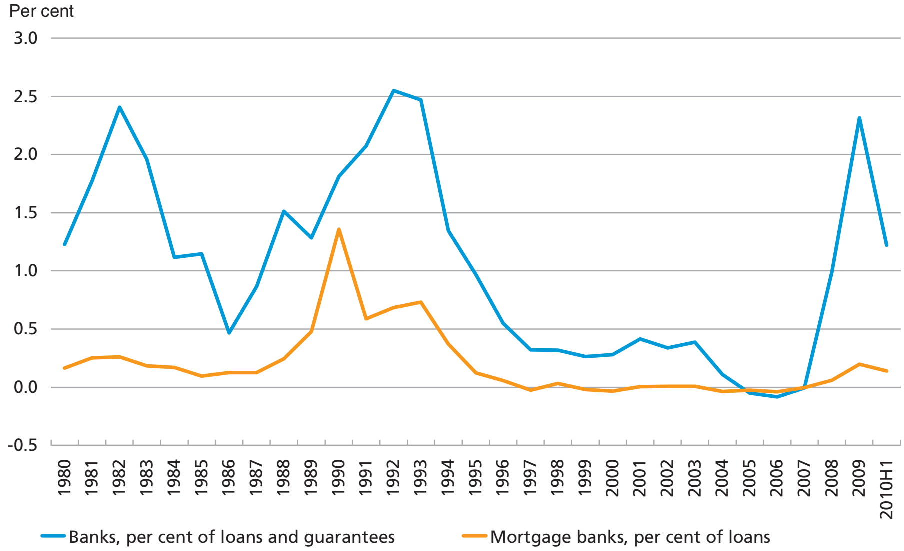
Source: Statistics Denmark and the Central Tax Administration (SKAT).

At the end of 1984, Denmark's seventh largest bank, Kronebanken, faced a crisis, and the period until the mid-1990s was characterised by many ailing banks. 102 banks discontinued their operations in the period 1985-95, 52 of them as a result of difficulties, cf. Mølgaard (2003). They were primarily small and medium-sized financial institutions, however, and part of the solution was often that the crisis-stricken institutions were taken over by other banks. Danmarks Nationalbank and the central government were directly involved in finding solutions for a few ailing banks, the bailout of Varde Bank – Denmark's ninth largest bank – being the largest in 1992/93.

In the late 1980s and especially the early 1990s Norway, Sweden and Finland saw actual systemic crises during which significant parts of the banking sector, including several nationwide banks, were in difficulties. Compared to the other Nordic countries, the Danish financial system was much less severely affected by the crisis in 1987-93 despite the banks' substantial write-downs, cf. Chart 6. This is attributable to various factors, cf. the Ministry of Economic Affairs (1994), Vastrup (2009) and Abildgren et al. (2010).

Throughout the 1970s and 1980s, the Danish financial sector had been subject to a gradual deregulation process which gave the financial institutions the necessary time to improve their risk management systems

BANKS' AND MORTGAGE BANKS' WRITE-DOWNS Chart 6



Note: As from 2005, banks' write-downs (losses and provisions) on loans are no longer calculated on the basis of a demonstrated risk of losses under the prudent accounting principle. Instead, a neutrality principle is applied to write down loans when there is prior objective evidence of impairment. In 1990 the principles for mortgage banks' write-downs were amended to the effect that, in future, provisions also had to be made for probable losses and not just for certain losses. In principle, part of the provisions in 1990 therefore concern previous years. Negative figures for write-downs indicate that previous write-downs are reversed as income. Figures for the 1st half of 2010 are adjusted to a full-year basis.

Source: Danish Financial Supervisory Authority.

and prepare for new, more deregulated market conditions. In the other Nordic countries the deregulation was implemented later and thus over a shorter period of time.

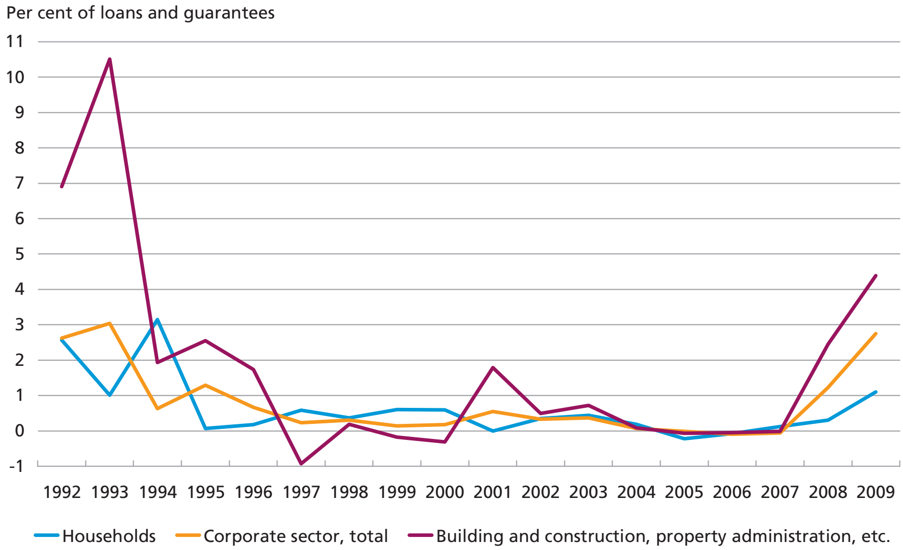
In Denmark write-downs and losses were also spread over a somewhat longer period and the worst crises were limited to small and medium-sized banks.

Furthermore, the pre-crisis capital requirements for banks were stricter in Denmark. In most countries the introduction of the Basel Committee's new capital requirements led to a tightening compared to the existing capital requirements when they came into force in the early 1990s. The transition to the Basel I rules on capital adequacy in Denmark, on the other hand, constituted a substantial easing of the statutory capital requirement for banks. This made it possible for Danish banks to absorb losses for a number of years of poor financial results.

Finally, the merger of six of the largest Danish banks with varying solvency ratios into two big banks in 1990 increased the resilience of the banking sector.

Even though Denmark was less hard hit by the crisis than the other Nordic countries, the write-downs in the Danish banking sector in the

BANKS' WRITE-DOWN RATIOS BY SECTOR Chart 7



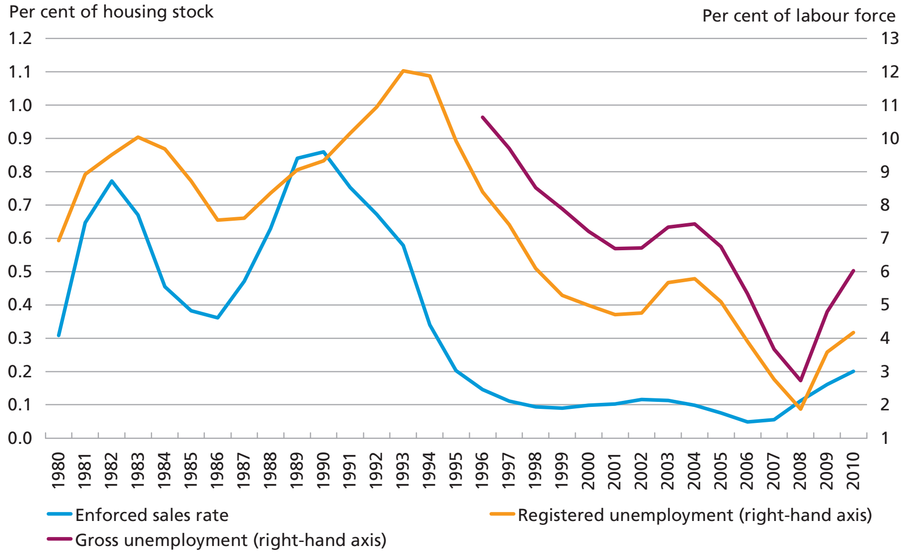
Note: Approximative calculation. Negative figures indicate that previous write-downs are reversed as income.
Source: Ministry of Economic Affairs (1994), Danish Financial Supervisory Authority and Danmarks Nationalbank.

early 1990s were relatively large. In particular, this was the case for banks that were strongly exposed to the construction and property sector, cf. Chart 7. In general, the write-down ratios were relatively high for lending to both the corporate and household sectors. This was a consequence of the general economic conditions, the fall in property prices and excess capacity of commercial properties. The number of enforced sales and unemployment was also high, cf. Chart 8.

Nor can there be any doubt about the severity of the crisis in the Danish financial sector in the 2nd half of the 1980s and especially in the early 1990s. In June 1992 Danmarks Nationalbank had to provide standby liquidity facilities for Denmark's second largest bank, Unibank, following rumours that the Danish Financial Supervisory Authority had taken special measures against the bank. Stability was quickly restored in relation to Unibank, but if the situation had developed unfavourably this might have had serious consequences for the stability of the Danish financial sector and the economy as a whole.

Danish mortgage banks also experienced some years of substantial write-downs from the end of the 1980s. Depreciation in the mortgage banks was particularly strong in 1990 when the principles of provisions were amended to the effect that, in future, provisions also had to be made for probable losses and not just for certain losses. In addition, certain mortgage banks tried to expand internationally in the 1980s, resulting in major losses.

ENFORCED SALES RATE AND UNEMPLOYMENT Chart 8



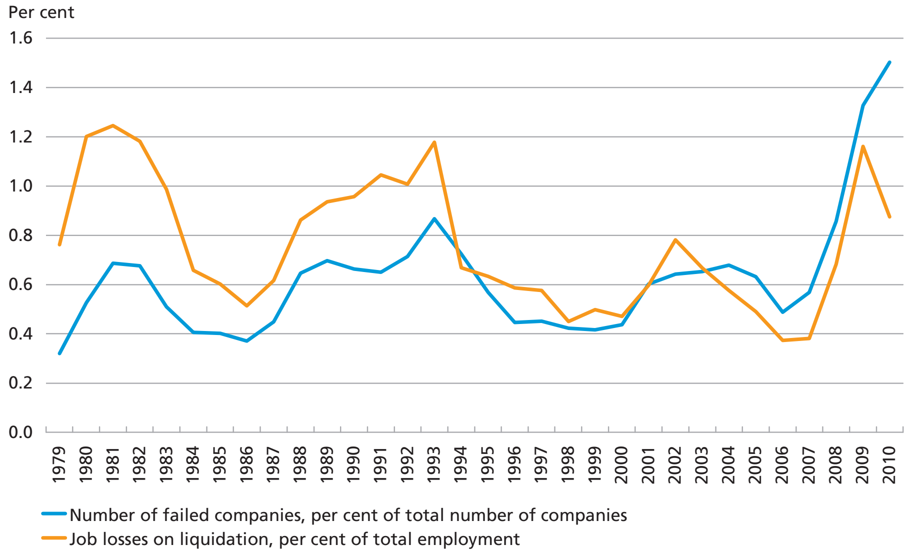
Note: The rate of enforced sales indicates the number of enforced sales (excluding farms) as a ratio of the number of homes. Gross unemployment comprises persons registered as unemployed and persons in activation schemes.
Source: Statistics Denmark and Ministry of Finance.

Finally, to illustrate the severity of the Danish crisis it should also be noted that some of the largest Danish insurance groups suffered major losses in the early 1990s and ceased to exist as independent business enterprises. The losses were not a result of the core activities (insurance) but rather they were related to loan-financed property investments, etc.

The financial crisis in recent years differs from the crisis in the early 1990s in several respects. The most striking difference has been the global nature of the crisis and the ensuing steep decline in Danish export market growth. The Danish corporate sector has been particularly affected by the crisis, experiencing the highest failure rates since the end of the 1970s, cf. Chart 9. So far, households have been less severely affected, which is reflected in a considerably lower level of enforced sales and fewer write-downs in the mortgage sector compared to the early 1990s. This should be viewed against the fact that despite an increase, unemployment is still at a relatively low level. Household finances have also benefited from a low level of interest rates on both short-term and long-term mortgage loans calculated after tax, cf. Chart 10.

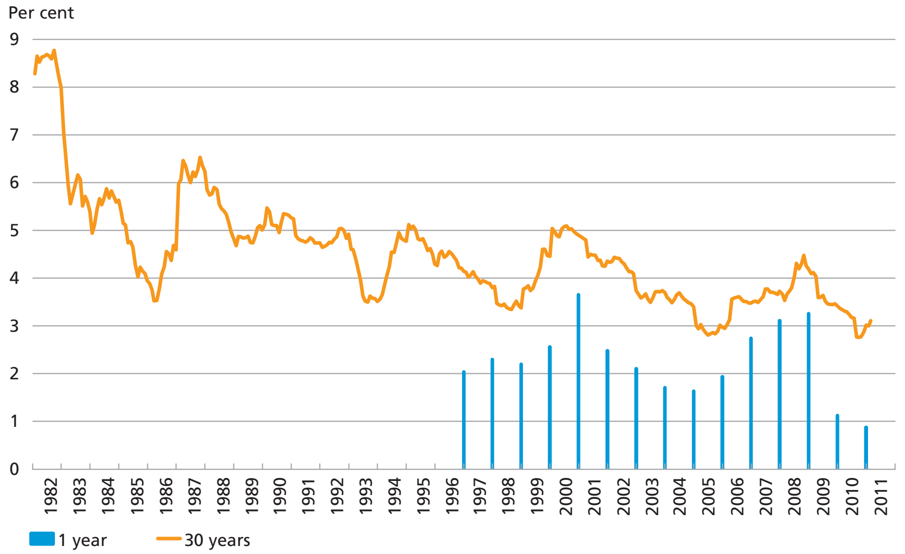
The banks' write-downs increased significantly in 2008 and compared to the situation in 1987-93, several medium-sized banks faced difficulties. Roskilde Bank, Forstædernes Bank, Fionia Bank and Amagerbanken, which were all among the 15 biggest Danish banks before the crisis, have ceased to exist as independent business enterprises in recent years.

RATE OF FAILED COMPANIES AND JOB LOSSES ON LIQUIDATION Chart 9



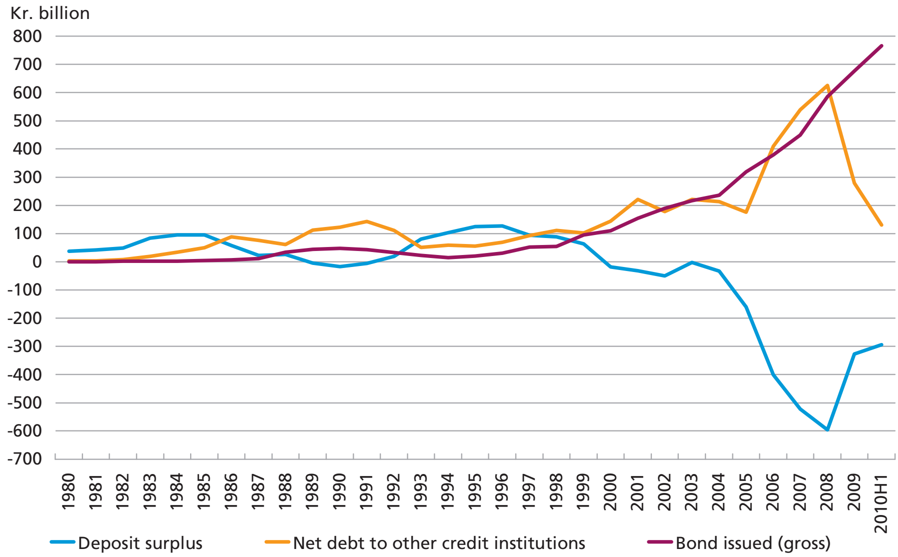
Note: Job losses on liquidation are measured by the number of employee claims submitted to the Employees' Guarantee Fund (Lønmodtagernes Garantifond – LG).
Source: Statistics Denmark and LG.

INTEREST AFTER TAX ON NEW MORTGAGE BONDS Chart 10



Note: Calculated on the basis of the tax rate for negative capital income. The bars for short-term interest rates indicate the average level of interest rates for 1-year adjustable-rate loans in December of the years concerned.
Source: Danmarks Nationalbank.

BANKS' DEPOSIT SURPLUS Chart 11



Source: The Danish Financial Supervisory Authority.

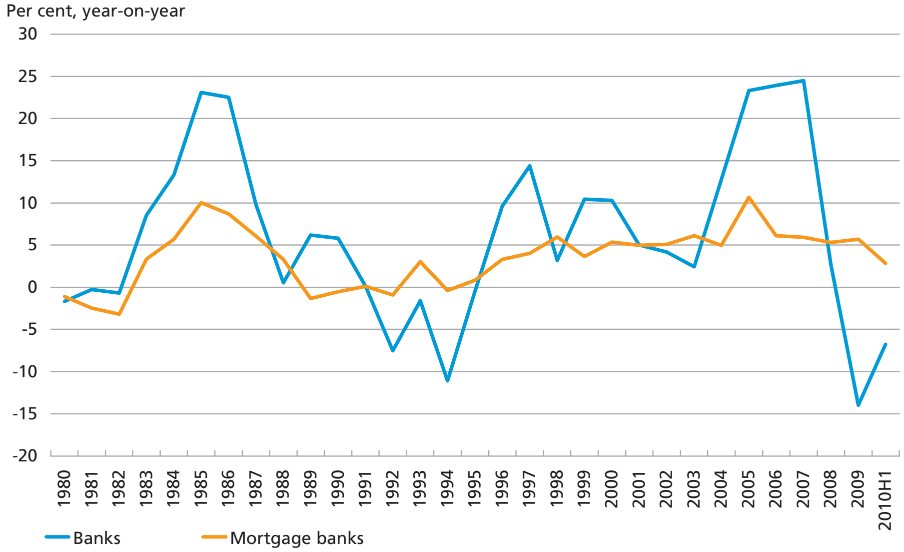
One of the significant differences between the crises in 1987-93 and 2008-09 is related to the shift in the bank funding structure around the millennium rollover, cf. Chart 11. Up until the end of the 1990s, the banks' deposits and lending were of more or less the same magnitude. In the years following the millennium rollover the banks accumulated large customer funding gaps during a period of strong lending growth. They financed the gaps, *inter alia,* by issuing short-term bonds and borrowing from foreign credit institutions. Short-term funding via the international money and capital markets is normally less stable and more sensitive to changes in the banks' own credit rating than deposits and long-term bond financing. Unlike the situation in the early 1990s, the crisis in 2008-09 was of a global nature, thus substantially compromising the functionality of the international money and capital markets, and this shift in the funding structure gave cause for concern and contributed considerably to the extensive government measures to support the banking sector. The concern related to the risk that in a situation of such general turmoil in the financial markets, the suspension of payments or failure of one bank and the ensuing losses of foreign unsecured creditors might have an adverse knock-on effect on other banks' borrowing abroad.

Another significant difference concerns the banks' buffers against losses. As mentioned above, the banks' large buffers in the 2nd half of the 1980s enabled them to absorb losses. That was not the case at the beginning of the most recent crisis. One of the reasons was the transition to new international accounting principles in 2005 according to which banks no longer had to make provisions for lending on the basis of a demonstrated risk of losses under the prudent accounting principle. Instead, loans were to be written down according to a neutrality principle when there was prior objective evidence of impairment. Accordingly, the new accounting rules of 2005 did not allow the build-up of "hidden" reserves, thereby reducing the buffers and providing room for increased credit expansion. Another reason was the easing of capital requirements in connection with the implementation of the Basel II capital adequacy rules in 2007 under which some banks chose to utilise the easing for additional lending.

A common feature prior to the crises in 1987-93 and 2008-10 was several years of high real growth in the banks' outstanding amounts of loans, cf. Chart 12. Historically, periods of high lending growth have often been followed by higher write-downs on loans and losses, indicating that credit quality tends to deteriorate during periods of high lending growth.

Another common feature of the two crises is the significant slowdown in the banks' lending growth in the wake of large write-downs during the crisis years while that has not been the case for mortgage banks. In effect, the tendency has been towards substitution by way of mortgage

REAL GROWTH IN BANKS' AND MORTGAGE INSTITUTES' OUTSTANDING LOANS AT YEAR-END — Chart 12



Note: Real growth is based on deflation by the consumer-price index.
Source: Statistics Denmark and the Ministry of Finance.

loans after the two crises. In the early 1990s this tendency was amplified by changes in mortgage legislation which facilitated mortgaging home equity without borrowers having to state the purpose.

Several discontinued banks in recent years differed from the sector as a whole in terms of a number of key accounting parameters. They were characterised by having shown particularly strong lending growth, many large exposures, a large customer funding gap and considerable exposure to the property sector compared to the banking sector as a whole, cf. Danmarks Nationalbank (2008). It is worth noting that many of the banks which went out of business in the 2nd half of the 1980s were also characterised by very strong lending growth and that many of the banks which ceased to exist in the early 1990s had relatively large property-related exposures, cf. Ministry of Economic Affairs (1995). In 2010, based on this experience from the two crises, the Danish Financial Supervisory Authority introduced as part of its bank supervision the "Supervisory Diamond" for banks, with a number of benchmarks for what must be defined as banking activity subject to enhanced risk, cf. Danish Financial Supervisory Authority (2010). The benchmarks of the Supervisory Diamond concern lending growth, property exposure, large exposures, excess liquidity cover and funding ratio (lending/deposits).

Finally, it was a common feature of the two crises that the problems in the financial sector coincided with pressure against the krone, cf. Danmarks Nationalbank (2009).

GOVERNMENT SUPPORT MEASURES AND FUTURE REGULATION OF THE FINANCIAL SECTOR

The periods 1987-93 and 2008-10 differ significantly in terms of the scope of government measures in support of financial stability and regulatory initiatives in response to the crises.

The original costs of the government and Danmarks Nationalbank by way of loans and outstanding guarantees, etc. related to the rescue of Danish banks (excluding Faroese banks) in the 2nd half of the 1980s and the early 1990s can be estimated at around kr. 5-6 billion. A large part of the original expenses were recouped, however, via repayment of loans provided and dividend from estates being wound up. Accordingly, the net expenses were less than kr. 1 billion estimated at the price level of the time. Apart from liquidity guarantees for a few crisis-stricken banks, the crisis did not entail a need for Danmarks Nationalbank to establish additional credit facilities.

Some of the bank crises in the 1980s led to a couple of specific measures. Firstly, 6' Juli Banken's suspension of payments in 1987, together with a wish to accommodate a recommendation in this area from the European Commission, gave rise to the introduction of a general deposit guarantee scheme in 1988. Secondly, Danmarks Nationalbank's losses in connection with the crisis in C&G Banken in 1987 led to the introduction, towards the end of the 1980s, of requirements for collateral in connection with the banks' day-to-day overdrafts on their current accounts at Danmarks Nationalbank.

Following the bailout of Varde Bank in the early 1990s, the government also decided that an account of the situation in the banking sector and expectations for developments in the coming years should be prepared. The account was prepared by the Interministerial Liaison Committee concerning the Financial Market. The report concluded that "... the difficult period for Danish banks must be viewed in light of the extraordinarily long period of low economic growth from 1987 – a period which followed a number of years of very high growth" (English translation of a quotation in Danish from p. 8). With respect to whether amendments to the current legislation were needed, the general conclusion of the report was that "... the existing rules in most areas is adequate and has been kept up to date on an ongoing basis" (English translation of a quotation in Danish from p. 10).

In some respects, however, adjustments to the legislation in the financial area were proposed, cf. the Appendix to Chapter 10 in the Ministry of Economic Affairs (1994). The proposals included a raising of the Depositor Guarantee Fund's coverage of ordinary deposits on suspension of payments or liquidation, which was implemented in 1995. Proposals were also presented to empower the Danish Financial Supervisory Authority to require extraordinary provisions on parts of the loan portfolios in banks with a particularly high risk profile. Such a regulation was implemented by an amendment to the Commercial Banks and Savings Banks Act in 1996.[1] According to the explanatory notes to this Act, the banks should be able to account for the provisions in the usual way, and to appeal them to the Company Appeals Board. In practice, however, the regulation did not come to play any major role, and it was abolished in 2003 when the Commercial Banks and Savings Banks Act was replaced by the Financial Business Act. The adoption of the Basel II rules on capital adequacy in 2007 introduced the possibility of applying differentiated capital requirements which were higher than the minimum capital requirement of 8 per cent so as to better reflect the risks incurred by the

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[1] Pursuant to Act No. 376 of 22 May 1996 and the Report on proposals for amendment of the Act to Amend the Commercial Banks and Savings Banks, etc. Act, the Act on Investment Associations and the Act on Insurance Business and various other Acts submitted by the Trade and Industry Committee on 30 April 1996.

individual banks. If the Danish Financial Supervisory Authority deems the board and management's assessment of the capital need to be inadequate, it may impose higher individual solvency requirements. However, these rules came too late to have any real impact prior to the recent banking crisis.

The support measures in favour of the financial sector have been on a much larger scale during the most recent financial crisis than in the period 1987-93. Like the central banks in other countries, Danmarks Nationalbank launched a series of temporary measures in connection with the financial crisis to improve the stability of the financial system. Additional credit facilities were established and the collateral base was expanded in a number of ways, cf. Dam and Risbjerg (2009).[1]

The government also launched a series of comprehensive initiatives, including a guarantee scheme which for a 2-year period ensured that all claims of depositors and other unsecured creditors in banks were fully covered. This was a very extensive government guarantee (kr. 4,200 billion or around 250 per cent of GDP). Moreover, the Financial Stability Company was established to manage ailing banks, and for a period of time, credit institutions were given the opportunity to receive government capital injections and purchase individual government guarantees, cf. Appendix A.

It is a common feature of the bank rescues involving the government during the crises in 1987-93 and 2008-10 that the solutions resulted in losses for the shareholders in the distressed banks. During both crises, the shareholders in certain banks lost their entire shareholdings, and the subordinated capital also sustained losses.

One difference between the two bank crises concerns the role of the European Commission in connection with government support measures to ensure financial stability. During the most recent financial crisis, the Commission has focused to a far greater degree than previously on ensuring that government measures in Denmark and other countries do not conflict with EU regulations on state aid.

It is not yet possible to compile the total central government net costs of the rescue packages for the financial sector during the most recent financial crisis.

In terms of the winding up of ailing banks under Bank Rescue Package I and the winding up of Roskilde Bank alone, the central government net profit at the end of the 3rd quarter of 2010, according to the Finan-

[1] According to Moessner and Allen (2010), the most recent financial crisis was characterised by central banks worldwide providing liquidity to the market to a much greater extent than was the case in connection with the banking crisis during the Great Depression in the early 1930s.

cial Stability Company,[1] was estimated at kr. 2.5 billion. This amount is arrived at by taking the difference between the guarantee commission and recourse guarantee of kr. 25 billion paid to the government by the Danish Contingency Association and subtracting government losses of kr. 22.5 billion.

As a result of Bank Rescue Package II, the central government has currently injected capital into a number of credit institutions. Furthermore the government has also provided individual government guarantees that may run until the end of 2013. These injections and guarantees provide income from interest and guarantee commission, but they may also result in losses. In the first part of February 2011, the Ministry of Economic and Business Affairs[2] presented the preliminary result of Bank Rescue Package II and the individual guarantees as a net profit for the central government of kr. 1.98 billion for the period 2009-11 after recognition of the preliminary bank losses in Amagerbanken and Eik Banki. This amount is arrived at by taking central-government interest revenue from capital injections and guarantee commission from individual government guarantees of kr. 9.25 billion in total and subtracting central-government losses of kr. 7.27 billion.

In the wake of the most recent financial crisis, a number of initiatives have been launched at the international level with a view to preventing similar serious crises from arising and developing in the future. Furthermore, the EU has established the European Systemic Risk Board, ESRB, which is to be responsible for financial stability surveillance in the EU. Even though work on regulatory measures is ongoing, there is no doubt that future financial legislation will tighten the liquidity and capital requirements for banks.

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[1] Cf. the notification "Finansiel Stabilitet A/S – regnskab for bankpakken" (The Financial Stability Company – accounts for the bank rescue package – in Danish only) of 4 February 2011.

[2] Cf. the memorandum "Foreløbig status for bankpakkerne" (Preliminary status for the bank rescue packages – in Danish only) from the Ministry of Economic and Business Affairs of 8 February 2011.

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APPENDIX A: OVERVIEW OF CENTRAL-GOVERNMENT MEASURES DURING THE FINANCIAL CRISIS SINCE 2008

Bank Rescue Package I ("the Bank Package"), October 2008

In early October 2008 the central government entered into an agreement with a broad majority of the parties in the Folketing (Danish Parliament). Under this agreement, the central government with the financial sector guaranteed that all claims of depositors and other unsecured creditors in banks that were members of the Danish Contingency Association would be fully covered for a 2-year period until 30 September 2010. The government guarantee was very extensive (kr. 4,200 billion or around 250 per cent of GDP), and the financial sector was required to contribute up to kr. 35 billion to the scheme. At the same time, the central government established a winding-up company, the Financial Stability Company, to manage the activities of ailing banks.

Overall, banks which had joined the Danish Contingency Association ended up paying kr. 25 billion (guarantee commission of kr. 15 billion and recourse guarantee of kr. 10 billion) in connection with Bank Rescue Package I.

Financial stability agreement for the pension sector, October 2008

The Danish mortgage market was also affected by the escalation of the financial crisis in the autumn of 2008. Yields on both short-term and long-term mortgage bonds increased considerably in September and October, and the yield spread to government bonds widened considerably. This widening affected pension companies, because the value of their mortgage bonds (assets) fell while the value of their life insurance provisions (liabilities) did not change, as mortgage bonds were not included in the discount rate used to calculate the life insurance provisions. Against this background, the Ministry of Economic and Business Affairs, the Danish Financial Supervisory Authority and the Danish Insurance Association agreed to launch a number of initiatives. As one of the initiatives, mortgage yield was temporarily included in the yield curve used in the calculation of the pension companies' liabilities. All other things being equal, this led to a reduction of the present value of the liabilities by about 0.5 per cent.

Amendment of the International Financial Reporting Standards, October 2008

In October 2008 the International Accounting Standards Board, IASB, adopted a revision of the International Financial Reporting Standards which offered listed enterprises certain possibilities of reclassifying their assets and liabilities on the balance sheet with retrospective effect from 1 July 2008. The possibilities concerned assets and liabilities included in trading portfolios, which normally had to be priced at fair value with recognition of value adjustments in the result. However, as a result of the international financial crisis, it had become difficult to accurately determine the price of certain financial claims due to illiquid markets. Reclassification according to the new rules made it possible to prevent major unrealised capital losses from affecting the profit and/or equity capital of the enterprise. The European Commission approved the new accounting standards in October 2008, and some major Danish banks chose to make use of the new possibilities immediately.

Bank Rescue Package II ("the Credit Package"), February 2009

In February 2009 a bill on government capital injections into credit institutions was passed by the Folketing in a situation where pressures on the solvency of credit institutions were expected to mount. The purpose was to recapitalise Danish banks and mortgage banks through government capital injections of up to kr. 100 billion in 2009 to prevent the financial crisis from developing into an outright credit crunch where creditworthy households and enterprises were unable to obtain credit.

In connection with the adoption of Bank Rescue Package II it was also made possible for credit institutions to purchase individual government guarantees for non-subordinated unsecured debt and for loans issued for financing top-up collateral.

Overall, 43 credit institutions received capital injections during 2009, totalling kr. 46 billion at an average yield to maturity of 10.08 per cent, and at the end of 2010, 50 institutions had issued for a total of kr. 193 billion with individual guarantees.

Increased deposit guarantee, October 2010

Concurrently with the expiry of the general government guarantee under Bank Rescue Package I, the deposit guarantee was increased to cover net deposits of up to approximately kr. 750,000 (100,000 euro), for ordinary deposits, while special deposits, including pension savings, remain fully covered.

Bank Rescue Package III, October 2010

Concurrently with the expiry of the general government guarantee under Bank Rescue Package I, a new model to manage ailing banks was also implemented. With the new model, the Financial Stability Company retains its option of acquiring and winding up ailing banks. If an ailing bank decides to be wound up via the model, Financial Stability establishes a subsidiary which acquires the activities of the ailing bank and winds it up. In this way the customers of an ailing bank are not forced to find a new bank at short notice.