IUHF WORLD CONGRESS

COMMENTS ON THE NEW REQUIREMENTS ON FINANCIAL INSTITUTIONS AND CONSUMER PROTECTION

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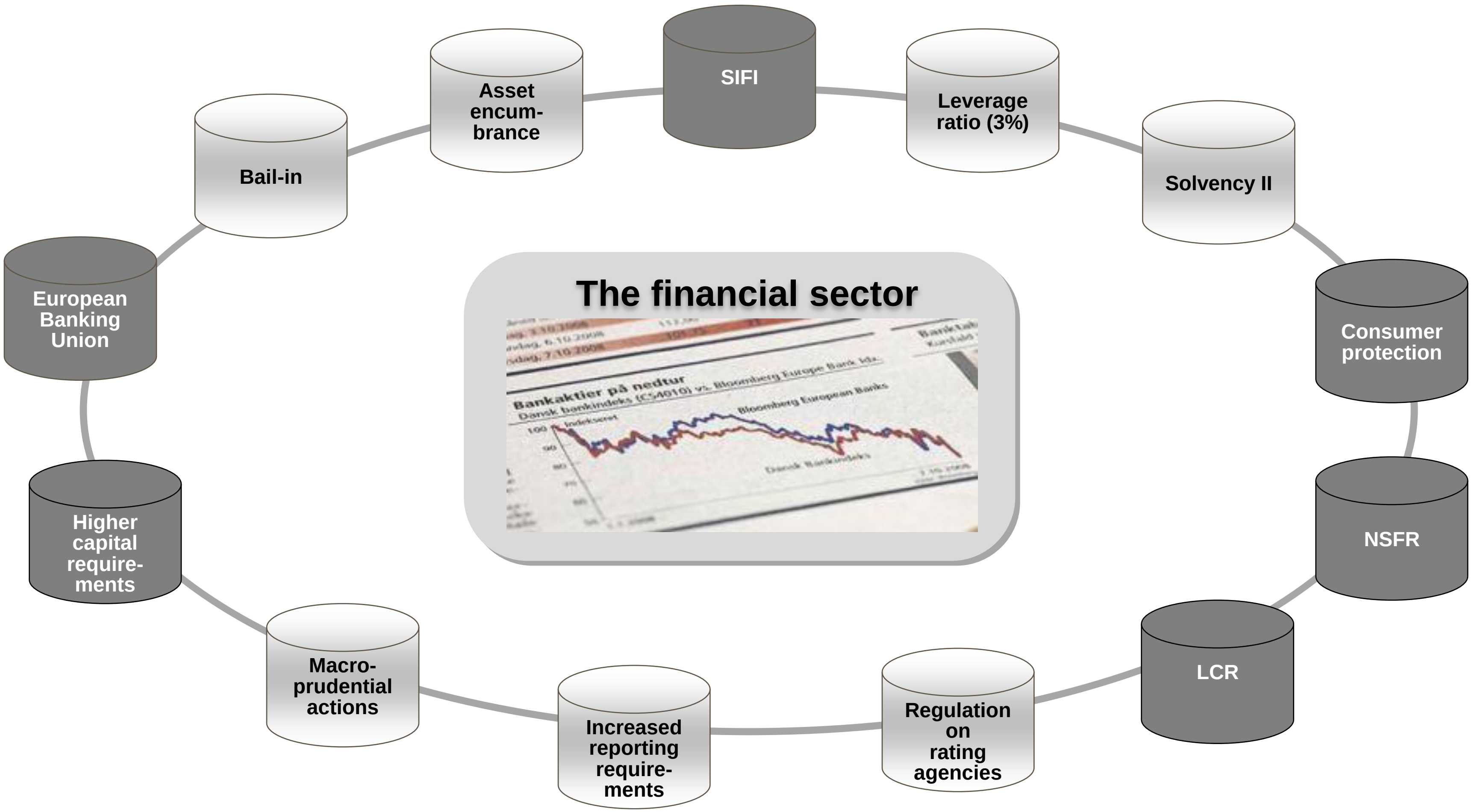
En god ven af huset

New legislation makes a big difference:
(Too) many initiatives to prevent a new crisis



It's all about ***trust*** in the financial system!

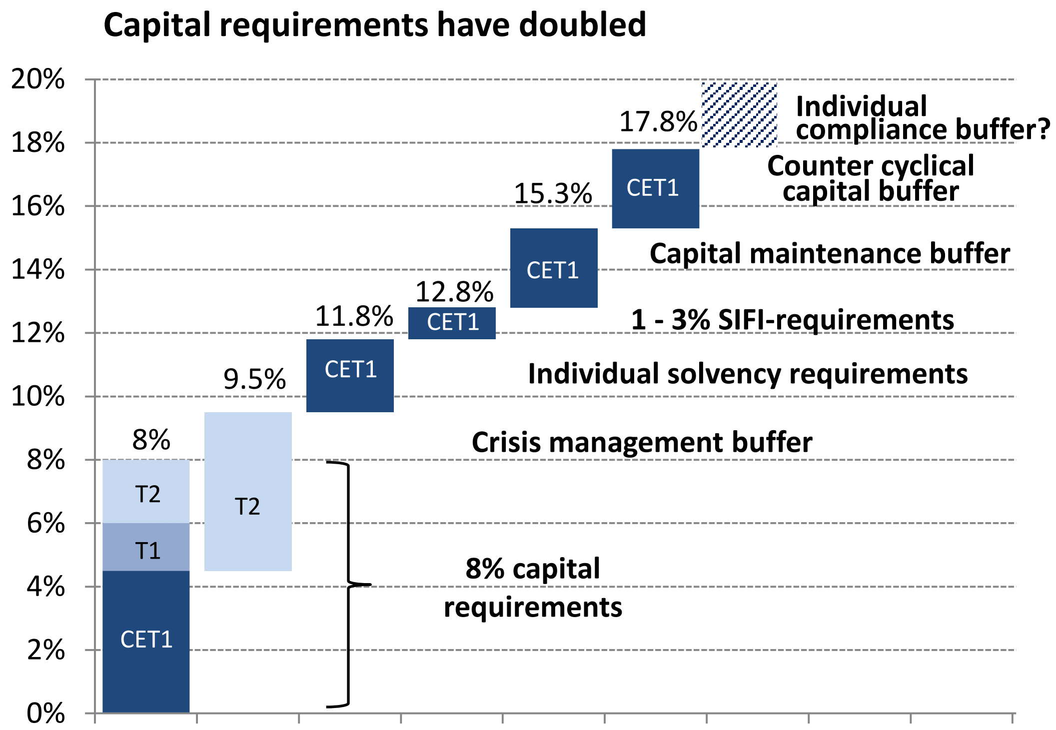
New ‘general’ requirements

- SIFI
- Increased capital requirements
- Liquidity requirements
- Increased government control (multiple reporting requirements / transparency)
- Consumer protection

SIFI – Systemically Important Financial Institutions – a new ‘Major League’?

- The Lehmann lesson: Higher standards are required for institutions that are ”too big to fail”
- SIFI’s will in general be required to carry more capital, be more liquid, have stricter governance and experience more control from FSA’s
- No uniform SIFI-definition
- Will SIFI’s be favored by customers and investors and thus have a competitive advantage compared to non-SIFI’s?

New capital requirements and crisis management mechanisms



CET1 = Actual core capital
T1 = Hybrid core capital
T2 = Subordinated capital

Capital conservation (15.3%)
- Prepare capital conservation plan

Recovery plan (12.8%)

Increased power to the Danish FSA (11.8%)
- Replacement of Executive Board and Board of Directors

Crisis managment plan (10.1%)
- Crisis management authorities take control

Liquidity requirements
Short-term (LCR – 30 days) and long-term (NSFR – 1 year)

- The financial crisis started out as a liquidity crisis – the interbank market simply dried out in mutual distrust
- In the future, the financial institutions must have a ‘liquidity buffer’ consisting of unencumbered assets to secure outgoing cash flows

Liquidity Coverage Ratio - LCR (30 days)

- To secure resistance in case of an acute liquidity crisis
- Liquidity reserves must account for 30 days net cash outflow

Net Stable Funding Ratio - NSFR (1 year)

- To promote more long-term funding
- Funding with a horizon less than 1 year is not considered as stable funding in terms of NSFR

In general, there are stricter requirements for assets that are considered to be particularly liquid / particularly safe

Liquidity requirements
Short-term (LCR – 30 days) and long-term (NSFR – 1 year)

- Which assets are particularly safe and liquid in a stressful situation?
- All market players will demand the 'particularly safe and liquid' assets
  - BUT – is there a sufficient supply of these assets?
  - Demand will be reflected in a high pricing
  - The price of assets which are not defined as particularly safe and liquid will probably decrease
- Is it in fact possible to sell or pledge the assets to another financial institution if the whole system is stressed?
- NSFR may affect products that are funded by short-term bonds, primarily ARM's
- Is there a real need for NSFR?

➡ ***We will still need central banks to take action in case of systemic stress***

Governance

FSA's

- The FSA's are more active in terms of on-site inspection
- Increased requirements regarding capital and liquidity reporting
- Requirements on recovery plans when defined limits are exceeded
- Access to replace the Board and Management
- Access to take over companies

Market discipline

- Companies must account for their risk organisation and significant risks in their business model
- Ongoing disclosure of risk ratios

Corporate governance

- The Management team and Board composition must reflect the experience and expertise in the chosen business model
- Establishment of new committees and functions - all risk committee, remuneration committee, etc.

The European Bank Resolution Framework

The four resolution tools:

1. Forced sale of businesses without the requirement of shareholder approval
2. Transfer of all or parts of the business to a bridge bank, publicly controlled and temporary in nature facilitating a subsequent sale
3. Transfer of impaired assets to a 'bad bank' to be 'worked out over time' – only in conjunction with one of the other resolution tools
4. Bailing-in of unsecured creditors.

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Conclusions on new regulation

- LCR may turn out problematic
- In Denmark, ARM's do not meet the Basel definition of NSFR
  - How will existing portfolios of 1 year ARMs be refinanced in 2018?
  - NSFR may still be adapted or rejected before 2018
- Authorities and politicians should realise that new regulation has a price – and that there is only the customer to pick up the bill
- Increased capital requirements will result in increasing prices or lending limitations – and may thus hamper growth. Risk adjusted pricing on customers will be even more widespread than today
- Stricter requirements to assets may affect the liquidity and pricing of covered bonds (UCIT's compliant)

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Consumer protection – the Danish experience…

- The Mortgage Credit Directive was recently adopted for all Mortgage Credit Institutions (MCI's) in the EU
- "Minimum" and uniform requirements on loan offerings and counseling have been standard for MCI's in Denmark for a long time
- On the positive side:
  - Counseling has been upped and is a competitive factor for providers
  - Consumers seem to trust the system (or are indifferent)
- On the negative side:
  - A loan offering now comprises of 80+ pages – including two summaries - and is still growing…(no warning is too small to be included)
  - Consumers are experiencing information overload and seem mostly indifferent to any other information than the monthly payment

"When something goes wrong" – the Danish consumer complaint system on mortgage credit:

1. Tier one: The consumer may complain to the provider and the provider is required to advise the customer on how to take the complaint further in the system in case of rejection
2. Tier two: The Mortgage Credit Appeals Board handles customer complaints in a court-like manner. 2012: 60 complaints on 360,000 loans disbursed
3. Tier three: Regular courts

The complaint system is generally swift and effective – and not much used.

Consumers may also complain to the Consumer Ombudsman and/or the FSA who in turn may take up cases on their own.

Consumer protection – trends and conclusions

- There seems to be no end to new requirements. However, in DK, the information overload is about to dawn on the authorities and there is serious talk of a new summary – on top of the two existing ones
- Requirements seem primarily to be driven by the authorities and politicians, not by public demand. In order to protect whom?
- The next big thing: Reversal of the burden of proof?
- Authorities and politicians should realize that consumer protection also comes at a price – and that there is only the consumer to pick up the bill.

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Final conclusions

- Higher capital requirements will lead to higher prices on financial services – and more prudent underwriting policies

- Increasing costs on governance and consumer protection may lead to consolidation amongst financial institutions and may thus affect the competitive situation

- In short: new requirements will most probably affect growth prospects negatively.

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