The Systemic Risk Council in Denmark: Assessing Strengths and Weaknesses*

By

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Abstract: The Systemic Risk Council is a relatively new entity in the role of adviser to the Government on issues concerning financial stability in Denmark. So far, the Council's work has mainly taken the form of recommendations to the Government in two areas: the countercyclical capital buffer and limitation of risky housing loans. This article accounts for the establishment of the Council, its legal framework, instruments and organisation. This is followed by a discussion of the need for changes to the Council's remit, macroprudential powers, governance and communication with the public.

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1. Introduction

In the wake of the financial crisis in 2008, a number of countries considered how their supervision of the financial sector could be organised as efficiently as possible.\(^1\) In Denmark, this resulted in the Government setting up the Committee on the Structure of Financial Supervision in Denmark in November 2010. The terms of reference for this Committee show that a number of EU member states were considering giving their central banks greater supervisory responsibility in the light of the financial crisis. The Committee was therefore to assess the Danish supervisory structure and possible alternatives on this basis (Ministry of Economic and Business Affairs, 2010).

However, the considerations about the Danish supervisory structure were quickly concluded, as, after the general election in September 2011, the new Government assessed that "it is not possible to find a suitable alternative organisation that also ensures that the Government has sufficient insight into and knowledge of financial matters" (Ministry of Economic and Business Affairs, 2012). Instead, in autumn 2011, the Minister for Business and Growth asked the Committee to "look at the issue of how to manage systemic financial risks and any need to establish a systemic risk council in Denmark" (Ministry of Economic and Business Affairs, 2012).

At the time, the European Systemic Risk Board (ESRB) had already been set up on 1 January 2010. The ESRB has a broad mandate in relation to preventing and mitigating the build-up of systemic financial risks in the EU and can make recommendations to EU member states in accordance with the so-called 'comply-or-explain principle'.

In December 2011, the ESRB recommended all member states to establish authorities responsible for managing systemic risks, for example in the form of a national systemic risk council. The background for the ESRB's recommendation was that the ESRB saw the need for an adequate institutional framework in the individual member states for effective systemic risk management, as the tools for countering such risks are applied at national level and not at EU level.

Based on the above, the Committee on the Structure of Financial Supervision in Denmark submitted a report in June 2012 on the establishment of a systemic risk council in Denmark (Ministry of Economic and Business Affairs, 2012). The Committee recommended that a systemic risk council be established in Denmark, and the establishment of the Systemic Risk Council was subsequently adopted in an act passed in December 2012. Since then, the Council has been the macroprudential authority in Denmark.

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\(^1\) The following predominantly descriptive presentation of the Council's establishment, legal framework, instruments and organization are based among others on Rohde and Sangill (2020).
2. Legal framework for the Council

The legislation defines the Systemic Risk Council as an advisory body whose tasks are 1) to identify and monitor systemic financial risks in Denmark, 2) to express opinions through observations on systemic financial risks, 3) to issue warnings about the build-up of systemic financial risks, 4) to make recommendations on initiatives in the financial area that can reduce or prevent the build-up of systemic financial risks and 5) to be consulted about warnings and recommendations from the European Systemic Risk Board, see The Systemic Risk Council (2013b).

That the Council is advisory means, in brief, that despite the Council being the macroprudential authority, it does not have the power to make independent decisions on macroprudential instruments, such as the countercyclical capital buffer. It can only seek to influence other players through observations, warnings and recommendations, see table 1.

However, the recipient of a recommendation must respond to this according to a 'comply-or-explain' principle. This means that the recipient is required, within a period of three months, either to comply with the recommendation or to present a statement explaining and arguing why the recommendation has not been complied with. If the recipient chooses the latter, the Council must publish an assessment of the consequences of such non-compliance for the systemic risks which the recommendation was intended to limit or prevent.

In accordance with the legislation, the Council's warnings and recommendations may generally be addressed to the Danish Financial Supervisory Authority and, if they concern legislation, to the Government. In practice, however, the Council has addressed all its warnings and recommendations to the Government. This primarily reflects that, after the establishment of the Council, the competence to decide on the macroprudential instruments, for example the countercyclical capital buffer, has been placed with the Minister for Industry, Business and Financial Affairs.

In relation to the housing market, where the Danish Financial Supervisory Authority may have had the instruments to comply with the Council’s recommendations, the Council has assessed that it was important to have clear political support for any measures. The Council has therefore also addressed its housing market recommendations to the Government.

According to the legislation, the Council must identify and monitor systemic financial risks in a broad sense. This also comprises areas that are only subject to financial regulation to a limited extent or not at all – the so-called shadow banking sector. In addition, the Council must be forward-looking and act early, as, in accordance with the legislation "It is important to identify systemic financial risks at an early stage so that initiatives can be taken to counter development of such risks before they reach a level where it becomes impossible to avoid significant adverse effects on the financial system and the real economy" (The Systemic Risk Council, 2013b).
Table 1. Framework for observations, warnings and recommendations

<table>
<thead>
<tr>
<th>Observation</th>
<th>Description</th>
<th>Contents</th>
<th>Publication</th>
<th>Follow-up</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observation</td>
<td>Risk of build-up of systemic financial risks which should be monitored more closely.</td>
<td>Reasoned description of the systemic risks that the observation concerns.</td>
<td>Is always published.</td>
<td>Does not trigger an obligation for the recipients to take action</td>
</tr>
<tr>
<td>Warning</td>
<td>Clear signs of build-up of systemic financial risks that it should be considered countering.</td>
<td>Reasoned description of the systemic risks that the warning concerns.</td>
<td>Will, as a general rule, be published unless the warning must be kept confidential for reasons of, for example, financial stability.</td>
<td>The recipient is obliged to submit a statement within three months, in which the warning is dealt with, including whether it gives rise to further assessments, the implementation of measures or the like. In special cases, however, the Council may decide that the statement must be submitted earlier. The Council must assess whether the acts or omissions, and the reasons given for these, are sufficient.</td>
</tr>
<tr>
<td>Recommendation</td>
<td>A specific proposal for the implementation of an initiative that will be expedient for limiting or countering identified systemic financial risks.</td>
<td>Reasoned description of the systemic risks that the recommendation concerns. If the recommendation contains specific proposals for amended legislation etc., reasons must also be given for why the proposal is regarded as suitable and proportionate in relation to countering the systemic risks that the recommendation concerns.</td>
<td>Will, as a general rule, be published unless the recommendation must be kept confidential for reasons of, for example, financial stability.</td>
<td>The recipient is obliged within three months either to comply with the recommendation or to present a statement explaining why the recommendation has not been complied with. In special cases, however, the Council may decide that the statement must be presented earlier. The Council must assess whether the acts or omissions, and the reasons given for these, are sufficient. If a published recommendation is not complied with, the Council must publish an assessment of the consequences of the non-compliance for the systemic risks.</td>
</tr>
</tbody>
</table>

Source: The Systemic Risk Council

However, the legislation also sets limits on the activities of the Council. The legislation thus explicitly stipulates that "The Council will not be addressing developments in general economic policy (e.g. finance policy, tax policy and monetary policy) or sector policy beyond the financial area." (The Systemic Risk Council, 2013b). As an example, the Council has therefore been prevented from commenting on housing taxation in its work on financial stability issues stemming from the housing market, which has taken up a large share of the Council’s activities.
3. The Council's members and secretariat

According to the legislation, the Council consists of ten members. Of these, (a) two members are from Danmarks Nationalbank, one of whom must be the Chairman of Danmarks Nationalbank's Board of Governors, who also chairs the Council; (b) two members from the Danish Financial Supervisory Authority; (c) three members from the economic ministries (the then Ministry of Business and Growth, the Ministry of Finance and the Ministry of Economic Affairs and the Interior)\(^2\), as well as three independent representatives, who are elected by the Government following consultation of Danmarks Nationalbank. The independent representatives must have sufficiently broad insight into the financial sector, including into the interplay between the macroeconomic development and the financial sector, either via research or from employment in the financial sector. In practice, the objective with the nomination and appointment of independent experts is that they will supplement each other with different perspectives on the Council's work.\(^3\)

In accordance with the legislation, the Council makes decisions on observations, warnings and recommendations by a simple majority of votes and with the Chairman of the Council having the casting vote in the event of a parity of votes. However, the representatives of the economic ministries as well as the Danish Financial Supervisory Authority do not have a voting right for observations, warnings and recommendations addressed to the Government.

In practice, this means that Danmarks Nationalbank and the independent experts have formally made the decisions on the Council's recommendations. However, the legislation also stipulates that "In order to strengthen the effect of recommendations made, the Systemic Risk Council shall strive for consensus." (The Systemic Risk Council, 2013b). Pursuant to the legislation, the representatives of the Government may thus assert that the Chairman of the Council should strive to ensure that the Council's recommendations can be supported by the Government. In accordance with the legislation, observations, warnings and recommendations addressed to the Government must also contain statements from the representatives of the ministries, to ensure that the public acquires knowledge of the Government's views.

A secretariat has been set up to assist the Council in its work and to prepare the material that forms the basis of the (minimum) four annual meetings held by the Council. In accordance with the legislation on this, Danmarks Nationalbank is the secretariat for the Council. The economic ministries and the Danish Financial Supervisory Authority participate in the secretariat. In addition, it follows from the Council's rules of procedure

\(^2\) The Government has only had two representatives on the Council during the periods in which the Government has distributed the work between the economic ministries in such a way that there have been only two economic ministries.

\(^3\) One representative has been able to see the development in systemic risks in Denmark on the basis of experience from another country. The first member in this role was Sigríður Benediktsdóttir, then Director of the Financial Stability Department of the Central Bank of Iceland, and she was replaced by Ida Wolden Bache, Deputy Governor of Norges Bank. A member with experience from the Danish financial sector, a role that has been filled by Peter Schütze, former CEO of Nordea Bank Danmark, throughout the life of the Council. Finally, the objective has been that one expert must come from the university world. In the period 2013-2017, this member was Torben M. Andersen, Professor at Aarhus University, and he was replaced by Svend E. Hougaard Jensen, Professor at Copenhagen Business School.
that Danmarks Nationalbank must appoint a head of the secretariat. The broad participation in the secretariat ensures that the analytical competences and financial insights of Danmarks Nationalbank, the Danish Financial Supervisory Authority and the ministries are utilised in the secretariat's work. In addition, it is ensured that Danmarks Nationalbank's and the Danish Financial Supervisory Authority's experience from the work in the ESRB is used on an ongoing basis.

4. International comparison of the institutional framework

Across Europe, the various countries have chosen a wide range of different institutional designs for their decisions on the macroprudential instruments in the EU's Capital Requirements Directive and Regulation, i.e. the countercyclical capital buffer, the systemic risk buffer and the SIFI buffer. However, the Danish model, under which the Government is responsible for determining these instruments, stands out and is only shared with Poland within the EU. The same setup can also be found to a certain extent in Norway.

Overall, the EU countries can be divided into two groups, see chart 1, left-hand side and right-hand side, respectively. In the first group, the macroprudential authority has direct control over the macroprudential instruments (chart 1, left-hand side). In this group, the most widespread system is that the central bank has been allocated the role of macroprudential authority as part of its mandate (twelve countries). However, two countries have chosen to set up a systemic risk council with direct control over macroprudential instruments, while two countries have allocated this role to their financial supervisory authority.

Chart 1. Macroprudential setup in the EU

In the second group of countries (see chart 1, right-hand side), the macroprudential authority does not have direct control over the macroprudential instruments, but must instead seek to convince another authority how
the instruments are to be applied. In this group, the macroprudential authority is a systemic risk council in nine out of eleven countries, while two countries have allocated this role to their central bank. In relation to the authority that decides the macroprudential instruments, this is the central bank (five countries) or the financial supervisory authority (two countries). In two countries (Denmark and Poland), however, this role has been allocated to the government. The Danish model, in which a systemic risk council has the task of convincing the Government of the need for a macroprudential policy, is thus very particular. Among Denmark’s neighbouring countries, however, the model can also be partially found in Norway. From September 2021, however, the Norwegian Government has given the central bank a mandate to independently determine the countercyclical capital buffer, while the other instruments will still be set by the Government.

5. The Council's use of its instruments

Since the Council was established, it has used its instruments a total of 16 times, 13 of which have been recommendations, all of which have been addressed to the Government, see table 2. In the following, we will review the recommendations with focus on the extent to which the incumbent governments have followed the Council's recommendations. The Council's recommendations can be divided into four groups: (1) Phasing in of legislation on capital adequacy requirements; (2) limitation of risky housing loans; (3) the countercyclical capital buffer and (4) systemic risks on the Faroe Islands.

Table 2. The Council's use of its instruments

<table>
<thead>
<tr>
<th>Date</th>
<th>Instrument</th>
<th>Area</th>
<th>Addressed to</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2013</td>
<td>Recommendation</td>
<td>Phasing in of legislation on capital adequacy</td>
<td>The Government</td>
</tr>
<tr>
<td>March 2015</td>
<td>Observation</td>
<td>_low interest rates and build-up of systemic</td>
<td>No specific recipient</td>
</tr>
<tr>
<td>March 2017</td>
<td>Recommendation</td>
<td>Limitation of risky loan types at high levels of indebtedness</td>
<td>The Government</td>
</tr>
<tr>
<td>December 2017</td>
<td>Recommendation</td>
<td>Activation of the systemic risk buffer on the Faroe Islands</td>
<td>The Government</td>
</tr>
<tr>
<td>April 2018</td>
<td>Recommendation</td>
<td>Increase in the systemic risk buffer rate on the Faroe Islands</td>
<td>The Government</td>
</tr>
</tbody>
</table>
5.1. Phasing in of legislation on capital adequacy requirements

In June 2013, the Council recommended to the Government that it submit a bill implementing the recommendations from the Committee on Systemically Important Financial Institutions (SIFIs) and implementing the capital adequacy and liquidity requirements of the EU’s capital requirements legislation (CRR/CRD IV). In relation to the latter, the Council also considers the speed at which the framework for the countercyclical capital buffer is implemented. The Council wants it to be possible to make full use of the countercyclical capital buffer from 2015, as it "will make it possible to use the entire buffer, in case credit growth and the broader economy develop in a way that would warrant its activation." (The Systemic Risk Council, 2013a). The Council also points out that it only wants the framework for the buffer to be phased in quickly, as the buffer can be set to zero at the time of commencement. The Council follows up on the Government's compliance with the recommendation in its press release after its meeting in March 2014 and concludes here that the Government has largely complied with the recommendation.

In relation to the framework for the countercyclical capital buffer, however, the Government has chosen to implement this gradually from 2015 to 2019. The Council notes, "... that if, for example, credit developments in the period up to 2019 would warrant a level of the countercyclical buffer that is higher than the one allowed under the gradually implemented framework, new legislation would be required." (The Systemic Risk Council, 2014a). Already with the Council's first recommendation, it was thus clear that the Government did not intend simply to follow the Council's recommendations uncritically. In practice, however, the gradual phasing in of the framework for the countercyclical capital buffer never became a real problem in relation to the Council's wishes for the build-up of the buffer.
5.2. Limitation of risky housing loans

The Government’s intention not to simply comply uncritically with the Council’s recommendations has especially made itself felt in relation to loans with deferred amortisation. In September 2014, the Council recommended that "...the Supervisory Diamond should be supplemented with legislation on lower borrowing limits for deferred amortisation loans as a ratio of the property value at the time of granting the loan." (The Systemic Risk Council, 2014b). Specifically, the Council emphasises that, in 2013, approx. 1/3 of the mortgage credit institutions' total new loans for owner-occupied homes with a loan-to-value between 60 and 80 per cent were loans with deferred amortisation. The Council also notes that: "The timing of a structural adjustment is good, given the low level of interest rates, which poses a risk of excessive indebtedness." (The Systemic Risk Council, 2014b).

At the time of the Council's recommendation, the Danish Financial Supervisory Authority has submitted a proposal for a supervisory diamond for mortgage credit institutions aimed at limiting loans with deferred amortisation. However, the Council does not find this proposal to be sufficient. The Government chooses to implement a somewhat more rigorous supervisory diamond than the one proposed at the time of the recommendation and supplements this with a down-payment-requirement of 5 per cent. Therefore, the Council finds after its meeting in March 2015 "...that systemic risks linked to deferred amortisation are reduced by the Supervisory Diamond but that there are still systemic risks linked to the mortgage banks' opportunities to grant deferred amortisation at high LTV-ratios." (The Systemic Risk Council, 2015).

The Council's next attempt to limit deferred amortisation is reflected in a recommendation in March 2017. Prior to this recommendation, the Council had held a conference on the housing market in 2016 and published a discussion paper on which stakeholders with housing market expertise were invited to submit written comments. In 2017, the Council recommended that the Government ensure a limitation of housing loans with variable interest rate and/or deferred amortisation where the borrower's total debt exceeds 400 per cent of the borrower's income before tax by imposing a maximum limit of 15 per cent of this type of loan from the mortgage credit institutions for homes in the City of Copenhagen and Greater Copenhagen and in Aarhus – or that the Government implement a similar initiative with corresponding effects on the housing market and lending (The Systemic Risk Council, 2017a).

In response to the recommendation, the Government chooses to introduce rules stipulating that if a household's debt exceeds 400 per cent of its income and the household exceeds a loan-to-value ratio of 60 per cent, a variable-rate loan cannot be granted with a shorter fixed-interest period than five years with or without deferred amortisation or a variable rate with a fixed-interest period of five years or more with deferred amortisation. Following the Council's meeting in December 2017, the Council finds that "...the government's follow-up of the Council's recommendation on risky loan types generally complies with the recommendation". However,
the Council also notes that "Nonetheless, access to deferred amortisation is not limited to the extent recommended" (The Systemic Risk Council, 2017b). It is thus again clear that the Government is not prepared to go as far as the Council wants in limiting loans with deferred amortisation.

The Council's latest attempt at limiting deferred amortisation is expressed in a recommendation in June 2021, in which the Council recommends to the Government that it restrict Danish homeowners' access to loans with deferred amortisation secured by mortgage on real property, so that Danish home owners cannot raise mortgage loans with deferred amortisation (or mortgage-like bank loans) secured by mortgage on real property if the loan-to-value ratio of the home exceeds 60 per cent (The Systemic Risk Council, 2021a). However, the Government has no appetite for a measure that limits loans with deferred amortisation, and the Council therefore assesses after its meeting in September 2021 "... that vulnerabilities in the housing market continue to be a source of systemic risks to both the economy and the financial system" (The Systemic Risk Council, 2021b).

5.3. Countercyclical capital buffer

The countercyclical capital buffer is one of the Council's most important macroprudential instruments. The intention with the buffer is that it is to be built up during periods with increasing risks in the financial system. Whereas it is to be released during periods with financial stress, so the credit institutions can use the released capital to maintain an appropriate level of credit allocation.

The Government has chosen to follow all the Council's recommendations for the countercyclical capital buffer. Even though it may thus seem irrelevant whether the Council can set the buffer itself or whether it is to recommend to the Government to make changes to the buffer rate, the reality is probably that the outcome could easily have been different, especially during the first build-up of the buffer starting in 2017, and that a situation could have arisen in which the Government would not comply with the Council's recommendation. Prior to the initial build-up of the buffer, the Council had conducted a dialogue with the sector, in which the sector expressed a wish that the Council should indicate its expectations for future changes to the buffer in its communication about the buffer. This would facilitate the banks' capital planning.

The Council's first recommendation on activation of the countercyclical capital buffer of 0.5 percentage points from December 2017 thus indicated that the Council expected to recommend an increase of the buffer by a further 0.5 percentage points within the coming year. However, this prompted the Government to state in its reply to the Council that it was not immediately prepared to comply with a recommendation to increase the buffers further: "The Government has noted that the Council expects to recommend increasing the buffer further within the coming year. If a recommendation is made for further buffer increases, the Government will assess the development in a number of areas, including credit allocation. At present, the development does not indicate that there will be a need to increase the requirement." (Ministry of Industry, Business and Financial
Affairs, 2018). The probable reason why the Government nevertheless chose to comply with the recommendation from September 2018 is that, in the meantime, the money laundering case in Danske Bank had increased the political appetite for making the sector more resilient.

5.4. Systemic risks on the Faroe Islands and in Greenland

The Council is not only responsible for macroprudential policy in Denmark, but has also been designated as the macroprudential authority on the Faroe Islands and in Greenland. The Council has found it necessary to recommend to the Government a number of initiatives aimed at limiting systemic risks on the Faroe Islands. In the Council's work with the Faroe Islands, it has conducted a close dialogue with the Faroese authorities, which have supported the Council's recommendations. The Danish Government has chosen to comply with all the Council's recommendations regarding the Faroe Islands.

6. Is there a need to change the framework for the Council?

So far, this article has focused on describing the Council's history, remit and operational part. In the following, we will discuss whether there is a need to change the way the Council operates. The presentation is structured in accordance with three selected areas: the Council's (1) institutional framework, (2) monitoring of systemic risks and (3) communication with the outside world.

6.1. Institutional framework

We find that the discussion of financial risks and macroprudential policies has received a qualitative boost as a result of the establishment of the Council. It is nevertheless an open question whether the institutional framework for the Council can adequately ensure that potentially unpopular decisions are made in time or whether the Council's clout is weakened as a result of a so-called 'inaction bias'. This term is used consistently by the IMF (2020a and 2020b) and refers to the way in which the Council makes its decisions.

The IMF recommends a more efficient decision-making procedure, including with reference to inertia in the build-up of the countercyclical capital buffer and the absence of intervention in relation to the household sector's indebtedness as examples of inaction bias.

The point is that the Council's work is subject to a consensus objective. Based on this, the IMF assesses that, prior to the quarterly meetings in the Council, the Council's secretariat is, in effect, obliged to prepare material, including proposals for macroprudential policy, which has already been 'tweaked' so much before being discussed by the Council's members that they are suitable for reaching a consensus. As the IMF sees it, this de facto gives each member of the Council a right of veto, although there are also benefits associated with a consensus model. As an alternative to this set-up, the IMF recommends a model that maintains the objective of consensus without this blocking a more effective decision-making procedure.
The IMF also emphasises that it can be difficult for the Council to obtain the most expedient decisions on financial stability, as not all members of the Council necessarily have financial stability as their top priority. In this way, other (perhaps conflicting) priorities may delay the implementation of the 'right' macroprudential policy. This 'inaction bias' is amplified in cases in which the costs of implementing macroprudential measures make themselves felt earlier and are more easily observable than the potential benefits. This phenomenon is also well known from other policy areas, for example labour market reforms, where socio-economically important decisions are postponed – or not implemented at all – because the costs manifest themselves earlier than the benefits. Conversely, it may be argued that precisely by bringing people with different interests and priorities together, it becomes possible to make decisions that cater to broad considerations.

The problem with inaction bias can also be viewed from another angle, namely that recommendations from the Council are 'soft law', i.e. not actual legislation. In the Council's activities to date, this has especially made itself felt in relation to the Council's recommendations on limitation of risky housing loans. In this area, the Government has rejected or only partially complied with the Council's recommendations three times: first in 2014, again in 2017 and most recently in 2021. This limited scope for action has resulted in inaction bias, where, as in the case of loans with deferred amortisation, it is very limited what has been done. The result may also be that the macroprudential initiative is taken with considerable delay or that, when action is finally taken, the intervention is an expression of a 'second best' measure because the 'consensus clause' may have deprived the initiative of the necessary impact.

One change of the institutional framework aimed at reducing the problem of inaction bias, which is also highlighted by the IMF, could be to give the Chairman of the Council an explicit legal mandate to propose recommendations which are presented in the Council, without first seeking consensus. This obviously does not exclude that the Chairman of the Council may choose to involve other Council members before presenting proposed recommendations in the Council, but it could limit the phase of consensus building before the secretariat begins preparing proposals for specific recommendations.

Another change in the framework that could also help reduce the inaction bias is to give the Council 'hard' powers over macroprudential instruments. One model would be to designate the Council as the authority responsible for macroprudential instruments. Such a model does not have to be 'all or nothing'. For example, instruments with clear distributional implications could remain with the Government, and the Council's role could still be to make recommendations in accordance with a comply-or-explain mechanism. Conversely, the direct control of instruments such as the countercyclical capital buffer could be transferred to the Council.

However, the Council has especially found it difficult to convince the Government of the necessity of the recommended measures in the housing market, where there are clear distributional implications. This challenge
could perhaps be reduced by giving the Minister for Industry, Business and Financial Affairs direct legal authority to implement measures in the housing market based on macroprudential considerations. This would make it clear in the legislation that macroprudential considerations are, in fact, intended to play a role in regulating the housing market. In such case, the Minister would not have to implement the Council’s recommendations for the housing market through consumer protection legislation.

A less extensive, but potentially important, initiative, which has also been proposed by the IMF, and which could be implemented with immediate effect, is to strengthen the Council's accountability and transparency. This could be done by including an overview of the Council’s recommendations in the Ministry of Industry, Business and Financial Affairs’ annual report to the Danish Parliament (Folketinget). This addresses a more general point, namely the need for communication, and thus the need for actual reporting, especially seeing that the Chairman of the Council is not available to the media, see below.

To conclude this issue, it is worth noting that there has been an intense international debate on the delegation of decision-making powers to independent bodies other than central banks. This applies not least in relation to fiscal policy advice. The big picture is that, especially because of the distributional issues, it is very difficult to delegate decision-making authority to bodies far removed from the democratically elected institutions. Another question is whether it is desirable based on a democratic principle. In that sense, the organisational structure with the Council is quite interesting, as this is a structure with clear expert signalling.

The actual decision is made by the Government, and it is thus a political decision where the Government may choose whether or not to comply with a recommendation. And as a key element: if it does not comply with a recommendation, it must explain itself. There is consequently visibility and greater political costs connected with non-compliance compared with a diffuse structure without correspondingly clear signalling. This is a significant step forward and a good structure in many ways. However, it is not without costs to the Council when its recommendations are not complied with. It challenges the relevance of the Council each time. And if it is repeated often, the Council risks becoming irrelevant. In a worst-case scenario, this dynamic may lead to a 'self-imposed inaction bias' on the Council, see Rohde (2018).

6.2. Analytical competence and monitoring of systemic risks

There is widespread recognition that the Council is supported by a secretariat with strong analytical capacity. Nevertheless, areas can be highlighted in which the Council could, to advantage, increase its focus in the future.

Firstly, there is the area of supervision of financial institutions that are not banks or mortgage credit institutions, i.e. pension funds, insurance companies, investment companies, funds, leasing companies etc. Increased focus on these areas will also be in accordance with the legislation for the Council, in which the so-called 'shadow banking sector' is directly mentioned.
Secondly, the Council can advantageously increase its focus on developing so-called macroprudential stress test models, which cannot only ascertain 'first round' effects of a negative shock to the financial system, i.e. the effect on the financial companies, but which can also demonstrate 'second round' effects, i.e. the effects on the real economy when financial companies react to the negative shock. This would improve the analytical basis for assessing the effect of macroprudential instruments, as one of the main purposes of these instruments is to limit 'second round' effects, thus stabilising the macroeconomic development. For example, the release of the countercyclical capital buffer in a crisis situation is to help ensure that the banks have the capacity to make loans to creditworthy customers.

6.3. Communication

A key issue concerns the Council's public visibility, including the extent to which material from the Council's work is published. The thorough and extensive material presented at the quarterly meetings of the Council, and prepared by the Secretariat, will not be made public, unlike reports prepared by the Danish Economic Councils.

It would probably strengthen the awareness of the work done by the Council if material on selected subjects, for example in relation to the housing market, was published to a greater extent. This could also be done more systematically by the reports prepared for the Council's quarterly meetings being divided into confidential sections and sections suitable for publication. However, a step in this direction will require that additional resources be allocated to the Council.

Finally, there is the question of who represents the Council externally. It is well known that the Chairman of the Council, Governor Lars Rohde, is not available to the media and others who would like an elaboration on the Council's activities (recommendations, observations, warnings, analyses etc.). This is necessary to avoid ambiguity about Danmarks Nationalbank's position. It is crucial for Danmarks Nationalbank to ensure a high degree of credibility about its activities, and this status would be challenged if the general public could experience a difference of opinion between the Chairman of Danmarks Nationalbank's Board of Governors and the Chairman of the Council (the very same person).

The absence of a public spokesperson on behalf of the Council is especially noticeable when the Council submits recommendations to the Government. Here, the media try hard to get comments from both the Chairman of the Council and the other members of the Council. To the extent that the media obtain a comment, it is, however, on the person's own behalf and not on behalf of the Council. This problem also illustrates that it would not necessarily solve the challenge of the Council's public visibility if more material from the Council were published. Increased visibility ultimately depends on the media, and they will naturally want a dialogue with the sender.
7. **Concluding remarks**

The Systemic Risk Council has contributed to strengthening the monitoring of financial risks in Denmark, and so far the Council has also managed to act as a catalyst for a number of expedient decisions in the macro-prudential area.

Based on the Council's secretariat, which builds up and coordinates knowledge across Danmarks Nationalbank, the Danish Financial Supervisory Authority and the economic ministries, a joint high level of knowledge is continuously obtained. Furthermore, by bringing together public decision-makers and independent experts in the financial and macroeconomic areas, the specialist basis for timely decisions in the financial area has been strengthened.

With the financial crisis as the background for the establishment of the Council, the incumbent government at any given time runs a significant reputational risk when choosing not to comply with the Council's recommendations. Until now, it is, in fact, more the rule than the exception that successive governments comply with the Council's recommendations. Measures aimed at the housing market are the clear exception to this pattern.

There may nevertheless be reason to point out some areas in which a strengthening of the Council's work may be required. First and foremost, the Council only has 'soft powers' and must therefore convince the Government that actions are necessary. Secondly, the Council must strive for consensus, which entails a risk that recommendations are diluted even before they are dealt with in the political process. And, thirdly, the Council has no voice in the public debate, as the only communication from the Council is via its website and the issue of press releases.

Seen in this light, our assessment is that a structure in which the Council had greater direct control over macroprudential instruments – especially instruments without major distributional consequences – and with a downgrading or modification of the 'consensus clause' could increase the likelihood that the necessary, but potentially unpopular, decisions in the macroprudential field will continue to be made. A statutory authority for the Minister for Industry, Business and Financial Affairs to implement measures in the housing market based on macroprudential considerations could also contribute to this.

However, we find that the IMF's arguments about consensus go a little too far. Firstly, there is clearly not such broad consensus in the Council that it only submits recommendations that are complied with by the Government. So the 'challenge' of reaching a consensus is certainly valid, even if one could wish that more recommendations were complied with. Secondly, consensus among those entitled to vote in relation to recommendations is crucial – the message is much stronger when there is a consensus, see the above, in relation to the division of responsibilities between expert signals/assessments and political decisions. If there is no agreement,
it will be easy for politicians to say that when there is no agreement among the experts, there is no reason to do anything.

Finally, it is clear to us that the structure of the tax system may affect financial risks, and it should therefore be reconsidered whether it is expedient for the Council to be cut off completely from this area. In the legislation, the Council is explicitly barred from commenting on tax legislation, despite the fact that the structure of the tax system can clearly have an impact on risk build-up in the financial area, for example via the housing market.

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