DANISH
SHIP FINANCE

Basel Committee on Banking Supervision
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PSC

"Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring"

Danish Ship Finance has reviewed the documents and is, generally speaking, supportive of initiatives with the goal of promoting a more resilient banking sector.

The work done so far is quite impressive.

The Danish covered bonds legislation is strongly focused on credit risk management as well as financial risk management, and the covered bond market in Denmark have been able to absorb the shocks arising from financial and economic stress, thereby meeting the objective of the Basel Committee's reform package.

It is of key importance that any new regulations de facto reward prudent risk management and not unintentionally spur financial institutions to reduce positions in liquid and low-risk assets as UCITS 22.4 and/or CRD-compliant covered bonds.

In that respect, we are worried by the increasing use of external ratings in the existing and proposed new regulatory framework.

Introducing more regulation depending on external ratings will, in our opinion, be counterproductive to the objective of prudent risk management, and does not stimulate the banks' own independent internal assessments of risk.

Well-regulated Danish issuers of covered bonds were able to sell bonds in the Danish market during the financial crisis with very small price differences, despite noticeable differences in external ratings, which we attribute to the banks' own risk assessments as well as the strong covered bond legal framework being closely monitored by the Danish FSA.

The current proposals seem to punish banks for doing their own assessment independent of the rating agencies as capital requirements and liquidity haircuts are suggested to be determined by external ratings.

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Moreover, due to the banking secrecy, private rating agencies will not achieve the same deep insight into a specific individual financial institution as is the case for the national supervisors (and the public accountants).

As we believe the following circumstances take effect, we see limitations for the use of external ratings for individual credit assessment:

- The banking secrecy
- The quality of the rating process being evaluated on a statistical basis only and not on the basis of the individual outcome
- There is no existing external board of appeal, and, moreover, that appeals made directly to the rating agencies must be based on information not previously available to the issuer or the rating agency.

With reference to "Addressing reliance on external credit ratings" (Page 55 of "Strengthening the resilience of the banking sector), we kindly encourage the Secretariat to consider other options than using external ratings or 100% Risk Weight.

At the least, we believe exemptions should be made for covered bonds.

We suggest that the national supervisors are provided with the power to assign and publish standard factors to be used in relation to risk assessment of covered bonds. Factors should be assigned for calculating Risk Weight, Leverage ratios, Liquidity haircuts etc., ensuring an incentive to buy liquid and low-risk assets.

The supervisors are clearly independent, and the UCITS 22.4 requirements combined with the balancing principle ensuring low financial risk proved to be resilient during the financial crisis and should not be unintentionally punished.

Yours faithfully
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Per Schnack