Swedish Bankers´ Association
Svenska Bankföreningen

POSITION PAPER
16th April 2010

Basel Committee on
Banking Supervision
By email to:
Baselcommittee@bis.org

Consultative document "International framework for liquidity risk measurement, standards and monitoring"

The Swedish Bankers' Association welcomes the opportunity to comment on the Basel Committee's consultative document "International framework for liquidity risk measurement, standards and monitoring".

As a member of the European Banking Federation (EBF) we support their response on the consultative document. The introductory part of the EBF position paper is attached (enclosure 1). We also attach our response to the European Commission's working document "Possible further changes to the capital requirement directive" (enclosure 2), in which we have more detailed comments on most of the issues.

In this short introduction we elaborate on a number of issues of special importance for Swedish banks.

We agree with the basic methodology proposed. The Liquidity Coverage Ratio, to cover the short-term liquidity risk, and the Net Stable Funding Ratio, to cover funding risk, are appropriate monitoring tools. However, with a too narrow definition of the liquidity buffer and too conservative assumptions for required and available funding, the proposed standards will be very costly for the banks and for society.

A quantitative liquidity regulation based on these measures is problematic since a minimum amount of liquid assets that must be maintained at all times will probably not constitute a buffer. With its most liquid asset locked up by a binding ratio, a bank faced with liquidity strains will have to use assets not part of the regulated requirement. As a precaution, it will be forced to hold liquid assets in excess of the minimum. In case the bank starts to use its liquidity reserve and is, as required, transparent about this the bank will send a signal that it has liquidity problems and is hence likely to get an accelerating liquidity problem. This is a fundamental problem that remains unsolved in the proposed standard. The proposed framework lack a mechanism for releasing the liquidity reserve and make it available for banks to be used in order to avoid or mitigate a liquidity problem.

The proposed framework takes liquidity´ self sufficiency as a point of departure, and thus that banks should disregard any kind of central bank support in their liquidity planning, both in the short term and in the long term. We share the view that this should be the guiding principle

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during normal business circumstances. We also share the view that every bank should have enough liquidity to survive in the short term (at least one month) without central bank support in a situation of severe idiosyncratic and market wide stress. In the longer term, however, central banks have an important role to provide liquidity support to solvent banks if banks should remain able to service society with maturity transformation and provide liquidity to their customers. It is of crucial importance that this role is considered and that this is reflected in the kind of assets that are eligible in liquidity portfolios, as well as the haircuts on those assets. If this will not be the case the regulation will become overly conservative with an unreasonable high cost to borrowers and to society, which will harm the economic development.

Since government debt may be scarce in some countries, e.g. in Sweden (and in the longer run everywhere), it is necessary to include other kind of liquid assets in the buffer. Covered bonds qualify very well since they are backed by a rigorous legislation guaranteeing that the bonds always are backed by collateral in high quality assets. Since this collateral is ring fenced covered bonds should also, according to our mind, qualify as liquid assets in the institution that has issued the bonds. It is evident that both the market and the rating agencies regards covered bonds as an asset that is significantly different than other debt issued by the issuing institution. Covered bonds are differently priced and rated than other debt issued by the issuing institution and are also in general much more liquid. In addition, the special covered bond legislation also creates special procedures that make it possible to continue to service the covered bond holders in case the issuer runs into bankruptcy.

The proposed liquidity regulation, as well as other proposed regulations, is likely to give banks an incentive to shrink their loan portfolios. The negative impact of these incentives will be less painful for society if covered bonds are included in the eligible assets.

It is our opinion that the proposed liquidity regulation in its entirety creates incentives to avoid long term funding of non-financial enterprises and encourages investment in marketable securities rather than loans, since lending is less liquid than marketable securities. In order to overcome these negative incentives banks can be expected both to reduce lending and to request significantly higher interest rates from its customers.

SWEDISH BANKERS´ ASSOCIATION
SVENSKA BANKFÖRENINGEN

Kerstin af Jochnick

Enclosure 1: EBF introduction
Enclosure 2: Response from the Swedish Bankers' Association on CRD IV

ENCLOSURE 1

European
Banking
Federation

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EBF COMMENTS ON THE BASEL COMMITTEE'S CONSULTATIVE DOCUMENT ENTITLED "INTERNATIONAL FRAMEWORK FOR LIQUIDITY RISK MEASUREMENT, STANDARDS AND MONITORING"

NEED FOR REFORM

1. We welcome the proposals made by the Committee and support many of the orientations that it proposes. The EBF (as well as the IIF) had informed the Basel Committee before the financial crisis of their view that the Supervisory Framework concerning banks' liquidity management had become obsolete. We are therefore pleased that the Committee now has proposed a new framework that will begin to address the reduction in systemic liquidity risk and achieve consistency of supervisory regimes globally across all material jurisdictions.

We believe that the proposals would need to be reviewed in light of the huge impact which they will have not only for the banking industry but for the economy as a whole. These effects should be carefully considered when amending the proposals to positively contribute to safeguarding financial market stability and preserving the overall funding and maturity transformation function of the banking system that is essential to finance the wider economy.

Moreover, the interplay between both liquidity ratios should be also thoroughly assessed in order not to duplicate the burden. We also think that the current draft should be reviewed to eliminate some inconsistencies and overlaps we have identified.

The EBF stands ready to be of assistance by providing constructive input and would like to strongly encourage the Committee to involve it in its future work. We believe it that it would in any event be appropriate for the Committee to organise another consultation process on the amendments that will be made to the Consultative Paper once the outcome of the Impact Assessment Exercise, which the Committee is currently undertaking, becomes available as it is expected to clarify the debate.

IMPACT OF THE PROPOSALS

2. We welcome the statement made in the Paper that the final calibration of the factors of the outflows and inflows as well as the composition of the stock of liquid assets will be

determined with a view to minimising the negative impact on the financial system and broader economy (paragraph 29). However, this will be a huge challenge as the new framework is likely to have far-reaching consequences.

Whilst we fully agree that the industry needs to strengthen its liquidity position, we would like to invite the supervisory community to discuss with the industry the potential macro-economic consequences of the proposals. There will also be an economic impact on markets for particular instruments, customers and market participants, including banks as well as unintended consequences.

The following consequences are worthwhile highlighting in particular:

Macro-economic Impact

- As such, the new requirements will lock up huge amounts of liquidity in the banking sector which will result in unnecessarily high levels of unproductive liquidity.

- The proposals will have a substantial impact on the banks' capacity to lend as the funding used to meet the ratios cannot be used for lending to consumers and business. This effect is particularly relevant for those countries in which the corporate landscape mainly consist of small and medium sized companies (SMEs) which typically do not issue credit-rated financing instruments and/or do not tap capital markets for financing (bank-based economies).

- The effect of the liquidity measures should, moreover, be seen in conjunction (i) with the new capital requirements which have been agreed upon by the Basel Committee in 2009 and those that are being proposed in its Resilience Paper and, furthermore, also (ii) with the need to reduce government deficits in the years to come.

Impact on Financial Stability

- The narrow definition of what is being considered liquid implies that the demand for those assets will increase whilst they will need to be stuck in the balance sheets of banks. As a result, overall liquidity – and, therefore, financial stability - will be reduced.
- The narrow definition will encourage herd behaviour - in normal circumstances and even more so in crisis situations - and result in concentrations in government instruments, which may intensify a liquidity squeeze.
- It is possible that trading assets which are eligible for the liquidity buffer (either in normal course of trading business or in rebalancing liquidity buffers) could be misinterpreted by the market as indicating a bank is experiencing a liquidity crisis.

- In addition there will be increased competition for all types of stable deposits. This will not only increase their price but may lead to the balances becoming less stable as customers become more aware of the value placed on their deposits.
- The narrowness of qualification for the liquidity buffer taken together with the treatment of non qualifying debt securities may result in a situation whereby, under stressed market conditions, the markets may automatically consider any asset that does not meet the criteria as illiquid. This behavioural pattern could, in future events, be the determining factor that shifts a stressed event into a major crisis.
- The Paper assumes that a 0% risk-weight under the Basel II standardised approach is a sufficient indication of the liquid nature of some assets. However, a general statement correlating credit risk to liquidity risk increases systemic risk. Moreover, a credit risk crisis would contribute more to a liquidity crisis if the liquidity buffer is narrowly defined!
- The proposals will increase pro-cyclicality with a risk that the new liquidity framework would magnify economic and/or financial markets fluctuations. One illustration is the spill-over effect which credit driven downgrades will have on the stock of high quality liquid assets: the stock will be inevitably be reduced as a consequence as their liquid quality is derived from credit ratings. Another illustration is the rumour-proning effect of liquidity disclosures.

Impact on some Instruments

- Re-pricing of asset classes may result in some products not being offered any longer, notwithstanding that they are useful to companies and retail clients.
- The new framework will result in a higher demand for those assets which are eligible for the liquidity buffers (particularly sovereign debt).
    - This is likely to distort the demand for instruments issued by the private sector (crowding out effect.
    - The framework may also have as an unintended consequence that the eligible asset classes (particularly sovereign debt) will become less liquid. It may be true that any shortage of sovereign debt is unlikely in the current environment of significant government deficit. However, there are long term concerns should governments recover their debts and thus restrict the availability of sovereign debt.).
    - A concentration issue may arise as the market will lack diversity in favour of a limited number of products.
    - A narrow definition is likely to increase the interdependence (i.e correlation) of highly liquid assets, increasing the likelihood of a possible liquidity shortage.
    - Equities - which is a category that has remained highly liquid throughout the recent crisis - could become less liquid.
- The circumstance that some instruments are not included in the range of qualifying asset classes will significantly remove incentives to hold these assets.

  - This is of a particular concern where financial instruments which are issued by financial institutions, are concerned as this will put severe price constraints on banks' funding as well as on the quality of their balance sheets.
  - The proposed NSFR will imply a requirement for 100 percent stable funding for financial bonds. As a consequence it will be very expensive for banks to hold bonds issued by other banks and this will increase the funding costs of banks in a considerable way.
  - The narrow definition is, in particular, likely to limit interbank lending to assets meeting the criteria - to the detriment of bank debt (such as unbreakable deposits for 3 months with other banks or CDs with another bank). This will reduce the flows in the interbank market (further reducing available credit in the economy) and/or increase interbank market rates that will necessarily need to be passed on to customers.
  - It will result in banks which are long of funds being restrained from investing in a diversified way.
- The proposed NSFR will discourage <u>market making</u> for a portion of those assets that do not qualify as being of a high quality (ex: corporate bonds, covered bonds, equities...).

<u>Impact on Market Participants</u>

- The proposals will result in reducing the amount of <u>maturity transformation</u> that banks undertake. Therefore, as there will be less liquidity in the economy, it is possible that other market players will need to step in to substitute banks for this necessary function in the economy, which means that maturity transformation would largely no longer be supervised but take place outside the banking industry and, consequently, outside of the supervisory framework and without access to banking safety nets (liquidity buffer, access to central banks...). As an example, corporates which plan to invest in long-term projects may prefer avoiding the high rates that banks will need to charge them and, as a consequence, may prefer funding themselves on a short-term basis.
- Transactions with other banks would be penalised in comparison to transactions with unregulated entities. This is a paradox and, moreover, likely to increase systemic risk.
- Implementing the proposed requirements will imply a huge burden and will be in particular be troublesome for <u>smaller banks</u> who may leave the market, further reducing available credit.
- Financial institutions which specialise in facilitating the <u>market making</u> in assets which are now proposed to be excluded from qualifying assets (or given no value in the denominator of the LCR) will see their business model disappear. The issuance of securities provided by financial institutions - such as covered bonds - has established a significant market in Europe more so than other locations and would more seriously affect this market.

- By not appropriately recognising the funding pattern of investment funds to custodian banks, the new liquidity ratios might increase the costs for all stakeholders with detrimental consequences for the activity of the custodian banks and for the investment fund industry as a whole.
- The proposals will reduce banks' profitability and, hence, their ability to raise funds in equity markets.

Impact on Banks' Customers

- The proposals will substantially increase the price that banks will charge to their customers, including retail clients to reflect the incremental liquidity costs because of the new regulatory liquidity framework.
- They will decrease the amount of lending offered by banks.
- Household savings will need to increase at the expense of consumption.

We assume that the Impact Assessment which is currently being undertaking will include an analysis of the impact of the proposals on all the factors mentioned above.

ENCLOSURE 2

Swedish Bankers´ Association
Svenska Bankföreningen

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POSITION PAPER
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European Commission
Internal Market and Services DG
By email to:
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Consultation paper from the European Commission on possible further changes to the Capital Requirement Directive

The Swedish Bankers´ Association welcomes the opportunity to comment on the Commission services staff working document "Possible further changes to the capital requirements directive".

General remarks

In general we support many of the initiatives taken, as a consequence of the financial crisis, to review the Basel II framework. When it comes to for example the quality of capital and the liquidity standards it is clear to us that there is much to learn from the crisis. At the same time it is important to bear in mind that the Basel II framework has only been in place for a short time and that it necessarily takes some time for the new regulation to have the desired effects on e.g. risk management and risk behavior. Sweden was among the first countries to fully implement the Basel II rules and we have since the implementation in 2007 seen many positive effects. It is also worth mentioning that Swedish banks have managed the financial crisis well compared to banks from many other countries.

The number of regulatory initiatives is currently very large. We want to underline that is has not been possible to fully understand and analyze all the proposals within the limited consultation period. Even if it might be possible to see the effects of each one of the proposals, we are worried about the total effects for banks, for the banks' customers, for the financial markets, for different kind of financial instruments and, last but not least, for the real economy and the process to recover after the crisis. Therefore we urge the Commission to, before a next step is taken, use the time necessary to analyze the total impact of the different proposals.

Another aspect is that many of the proposals are still incomplete and therefore difficult to analyze and comment on. As long as the composition and the calibration of for example the liquidity requirements and the leverage ratio are not clear it is hardly possible to analyze the effects for the banking system and for the real economy. An example: If a leverage ratio is introduced as a hard limit which hits low risk banking it will have severe effects for many Swedish banks and for the banks' abilities to support its customers. On the other hand, if a

leverage ratio is introduced as a soft limit within pillar 2 and focusing on how the ratio develops over time rather than on the ratio as such, it could be used as a supervisory tool. Our conclusion is that it is absolutely necessary to conduct at least one more consultation, including more detailed proposals, before a decision on a new framework can be made.

In the following part we will emphasize some of our most important comments to the proposal from the Commission. After that we will answer the detailed questions in the consultation document.

Most important issues from a Swedish perspective

Liquidity standards

The proposed liquidity standards will be costly for society. It will have far-reaching consequences not only for the banking industry but also for the real economy, the markets for the relevant instruments and for the customers.

We are of the opinion that it is necessary to include covered bonds in the liquidity buffer. Covered bonds qualify very well since they are backed by a rigorous legislation guaranteeing that the bonds always are backed by collateral in high quality assets. The suggested haircuts of 20 or 40 percent are overly conservative and do not reflect the high quality of covered bonds. Nor do they reflect the haircuts on covered bonds used by the central banks. In Sweden covered bonds are eligible for lending to the central bank with haircuts between 1 and 7.5 percent depending on maturity. Our suggestion is that the Commission adjusts the haircuts to be more in line with the outcome of the crisis.

Definition of capital

In general we welcome the aim of introducing a common definition of capital. However, we do not understand why instruments providing preferential rights for dividend payment on a non-cumulative basis would be excluded from Core Tier 1. We cannot see how a preferential treatment of dividend would change the loss absorbing capacity of the shares. The important factor is that the shareholders collectively are subordinated to all other claim holders, and thus jointly represent the most subordinated class or "the last line of defence" both during going concern and in liquidation.

Leverage ratio

We strongly oppose an introduction of a leverage ratio. In our view such a ratio, not taking the level of risk within a bank into consideration, not only removes the incentives for good risk management but also gives incentives to focus on high risk banking rather than traditional retail banking activities. As a result a rigid and badly used leverage ratio could raise the total risk in the banking industry.

If a leverage ratio is to be introduced it is essential that it is used as a soft measure within the pillar 2 framework. In our view it should also focus on how the ratio develops over time rather than on the ratio as such.

Liquidity standards for credit institutions and investment firms

In our opinion the proposed regulation will be costly for society. It will have far-reaching consequences not only for the banking industry but also for the real economy, the markets for the relevant instruments and for the customers. The requirements will have a considerable impact on the banks' possibility to lend as the funding used to meet the ratios cannot be used for lending. The regulation might also create illiquid markets for the relevant assets. The conservative definition of what is being considered liquid will lead to an increased demand for those assets whilst they will be stuck in the balance sheets. Therefore overall liquidity might be reduced.

We agree with the basic methodology proposed by the Commission. The Liquidity Coverage Requirement, to cover the short-term liquidity risk, and the Net Stable Funding Requirement, to cover funding risk, are appropriate monitoring tools. A quantitative liquidity regulation based on these measures is however problematic since a minimum amount of liquid assets that must be maintained at all times will probably not constitute a buffer. With its most liquid asset locked up by a binding ratio, a bank faced with liquidity constraints will have to use assets not part of the regulated requirement. As a precaution, it will be forced to hold liquid assets in excess of the minimum. In case the bank starts to use its liquidity reserve and is, as required, transparent about this the bank will send a signal that it has liquidity problems and is hence likely to get an accelerating liquidity problem. This is a fundamental problem that remains unsolved in the proposed standard. The proposed framework lack a mechanism for releasing the liquidity reserve and make it available for banks to be used in order to avoid or mitigate a liquidity problem.

The proposed framework takes liquidity self sufficiency as a point of departure, and thus that banks should disregard any kind of central bank support in their liquidity planning, both in the short term and in the long term. We share the view that this should be the guiding principle during normal business circumstances. We also share the view that every bank should have enough liquidity to survive in the short term (at least one month) without central bank support in a situation of severe idiosyncratic and market wide stress. In the longer term, however, central banks have an important role to provide liquidity support to solvent banks if banks should remain able to service society with maturity transformation and provide liquidity to their customers. It is of crucial importance that this role is considered in the new liquidity framework and that this is reflected in the kind of assets that are eligible in liquidity portfolios, as well as in the haircuts on those assets. If this will not be the case the regulation will become overly conservative with an unreasonable high cost to borrowers and to society, which will harm the economic development.

As the suggested requirements will limit the maturity transformation role of banks, others can be expected to take that role to substitute banks for this necessary function in the economy. Hence the maturity transformation would to a large extent take place outside of the regulated sector and without the safety net for society that supervision provides.

In our mind it is evident that (risk adjusted) solvency is the key requirement when trying to build a framework that minimizes liquidity risk in the banking system and that the central bank has an important role to fulfil as the lender of last resort in a framework that is manageable and not too costly for society.

***Question 1**: Comments are sought on the concept of the Liquidity Coverage Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex I. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.*

As been said above a quantitative liquidity regulation is problematic since a minimum amount of liquid assets that must be maintained at all times does not constitute a buffer. In case the bank starts to use its liquidity reserve and is, as required, transparent about this the bank will send a signal that it has liquidity problems and is hence likely to get an accelerating liquidity problem.

In addition the calibration of the requirement and the composition of the buffer, that will be mandatory for banks to hold, are of major importance for Swedish banks. To us it is not clear how the various run-off parameters, haircuts and other percentages in the proposal have been derived as they seems to be overly conservative. The percentages will set the level of credit available in the economy and it is therefore vital that they are set at appropriate levels.

Furthermore it is very important that the Commission looks at the consequences that the suggested requirement will have on the market. The suggested haircuts and what is included in the buffer is very conservative and will have major consequences for the relevant markets. A narrow definition of the buffer will increase concentration in eligible assets and affect the liquidity and pricing on assets not included in the buffer.

A too narrow definition of the buffer might also lead to a problem when, in the event of a systemic crisis, all banks at the same time would want to liquidate the same kind of assets. If this would happen it may create an oversupply that will make the assets illiquid and drive the prices down, which in turn would even worsen the crisis.

Another major problem with the proposed standard is the fact that bank bonds are not eligible in the liquidity reserve and are object of an unduly large haircut in the NSFR-calculation. This is in our mind too conservative considering the liquidity and haircuts actually observed during the crises. It is also very unfortunate since the banks do have to issue significant amounts of new debt as a consequence of the new liquidity framework. To make the assumption that these bonds would be totally illiquid from the banks' perspective will severely hamper the banks' ability to raise the funds necessary to, at the same time, both fulfil the requirements and fund their loan portfolios.

***Question 2**: In particular, views would be welcome on whether certain corporate and covered bonds should also be eligible for the buffer (see Annex I) and whether central bank eligibility should be mandatory for the buffer assets?*

Since government debt may be scarce in some countries, e.g. in Sweden (and in the longer run in many countries), it is necessary to include other kind of liquid assets in the buffer. Covered bonds qualify very well since they are backed by a rigorous legislation guaranteeing that the bonds always are backed by collateral in high quality assets. Since this collateral is ring fenced covered bonds should also, according to our mind, qualify as liquid assets in the

institution that has issued the bonds. It is evident that both the market and the rating agencies regards covered bonds as an asset that is significantly different from other debt issued by the issuing institution. Covered bonds are differently priced and rated than other debt issued by the issuing institution and are also, in general, much more liquid. In addition, the special covered bond legislation also creates special procedures that make it possible to continue to service the covered bond holders in case the issuer runs into bankruptcy.

The suggested haircuts of 20 or 40 percent are, in a comparison with the actual outcome of the crisis, however overly conservative and do not reflect the high quality of these bonds. Nor do they reflect the haircuts on covered bonds used by central banks. In Sweden covered bonds are eligible for lending to the central bank with haircuts between 1 and 7.5 percent depending on maturity. Our suggestion is that the Commission adjusts the haircuts to be more in line with the outcome of the crisis. To assume that a stressed scenario would go much further than the actual crisis seems, to us, overly conservative.

The proposed liquidity regulation, as well as other proposed regulations, is likely to give banks an incentive to shrink their loan portfolios. The negative impact of these incentives will be less painful for society if covered bonds are included in eligible assets.

In countries where the central bank acts as lender of last resort central bank eligibility is a natural requirement for assets eligible for the buffer. We think it is problematic that the definition of which assets are central bank eligible is not harmonised in the different countries.

***Question 3**: Views are also sought on the possible implications of including various financial instruments in the buffer and of their tentative factors (see Annex I) for the primary and secondary markets in which these products are traded and their participants.*

Assets included in the buffer will meet a higher demand which may improve liquidity, but at the same time the market turnover in these instruments may decrease since it can be expected that trading in the bank's liquidity portfolios, that should be kept separately from the ordinary trading and repo activities of the bank, will be significantly lower than for assets held outside the liquidity portfolios.

***Question 4**: Comments are sought on the concept of the Net Stable Funding Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex II. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.*

A quantitative liquidity regulation is problematic since it must be met all the time. If the bank also is required to be transparent and frequently inform about how it is fulfilling the requirement the problem will increase. In case the bank has a problem to issue new debt and starts to use its liquidity reserve to pay back maturing debt and is, as required, transparent about this, the bank will send a signal that is has liquidity problems and is hence likely to get an accelerating liquidity problem. In our mind the proposed regulation will thus not increase the institutions resilience to liquidity risk.

In addition, the requirement to invest excess funding in liquid assets (with a low RSF-factor) will increase the leverage in the financial system or crowd out lending (or both).

We also see a number of issues arising on the application of the requirement:

- The requirement is not adapted to the various business models that banks have. Due to the different business models the requirement will have drastically different impacts on different types of banks. A retail bank cannot be treated in the same way as an investment bank. The proposed one-size-fits-all system does not address the differences in liquidity risk in different countries, markets and institutions. Nor does it reflect the differences in risk appetite that different banks have.
- The scenario ignores the fact that banks will have the possibility to change their business strategy and balance sheet during the one year scenario.
- For capital adequacy the requirement is that every bank, at the same time, should be able to manage stressed conditions. For the NSFR the idiosyncratic stress scenario would imply that the liquidity has to go from one part to another. Therefore, the requirement that all banks should be able to handle this kind of stressed situation at the same time does not seem reasonable.
- As long as the calibration of assets does not take into account the flexibility of local loan markets and the credit quality of credit customers it will not reflect the liquidity of a bank's loan portfolio. When loan markets are flexible and the time needed to process a new loan agreement is short (as is the case in Sweden), high quality customers will easily find a new lender in case their original lender has a liquidity problem and as a consequence raises the interest rate required to roll over a maturing loan. As a consequence maturing loans to such customers does not require stable funding to the same extent as lending to customers in lower risk grades. This is also the case when the bank is able to increase customer interest rates during the agreed term of the loan.

***Question 5**: Comments are in particular sought on the merits of allowing less than 100% stable funding for commercial lending that has a contractual maturity of less than one year. Is it realistic to assume that lending is reduced under liquidity stress at the expense of risking established client relationships? Does such a differentiation between lending with more and with less than one year maturity set undesirable incentives that could discourage for instance long term funding of non-financial enterprises or encourage investment in marketable securities rather than loans?*

We believe that it is realistic to assume that lending is reduced under liquidity stress at the expense of risking established client relationships, since the cost of the bank defaulting is far higher than the cost of damaging an established client relationship.

It is our opinion that the proposed liquidity regulation in its entirety creates incentives to avoid long term funding of non-financial enterprises and encourages investment in marketable securities rather than loans, since lending is less liquid than marketable securities. In order to overcome these negative incentives banks can be expected both to reduce lending and to request significantly higher interest rates from its customers.

Question 6*: Views are sought on possible implications of inclusion and tentative "availability factors" (see Annex II) pertaining to various sources of stable funding for respective markets and funding suppliers. Would there be any implications of the tentative required degree of coverage for various asset categories for respective bank clients?*

It is our impression that the availability factors for deposits are far too punitive, both from a Swedish, Nordic and Baltic perspective.

Question 7*: Do you agree that all parameters should be transparently set at European level, possibly in the form of Technical Standards by the EBA where parameters need to reflect specific sub-categories of retail deposits?*

Yes we agree. Market culture and legislation still varies significantly between different European countries. Parameters reflecting different customer behaviour within the different member states need to reflect this if they should be relevant and reliable. Whether parameters are set by EBA or local supervisors are of less importance as long as a diversification reflecting local circumstances is achieved. In order to avoid competition distortions parameters reflecting customer behaviour in a local market should be applied among all banks active in the particular market, regardless of the bank's domicile.

Question 8*: In your view, what are the categories of deposits that require a different treatment from that in Annexes I and II and why? Please provide evidence relating to the behaviour of such deposits under stress.*

No particular comments.

Question 9*: Comments are sought on the scope of application as set out above and in particular on the criteria referred to in point 17 for both domestic entities and entities located in another Member State.*

The possibility to waive the requirements in point 16 as outlined in point 17 will improve banking groups' ability to manage funding and liquidity efficiently. The requirements are reasonable.

Question 10*: Should entities other than credit institutions and 730K investment firms be subject to stand-alone liquidity standards? Should other entities be included in the scope of consolidated liquidity requirements of a banking group even if not subject to stand-alone liquidity standards (i.e. financial institutions or 50K or 125K investment firms)?*

No particular comments.

Question 11*: Should the standard apply in a modified form to investment firms? Should all 730K investment firms be included in the scope, or are there some that should be exempted?*

No particular comments.

Question 12: *Comments are sought on the different options and in particular for how they would operate for the treatment of intra-group loans and deposits and for intra-group commitments, respectively. Comments are also sought as to whether there should be a difference made between the liquidity coverage and the net stable funding ratio.*

We appreciate that the Commission recognizes the problem with the asymmetric treatment of intra-group transactions when calculating the LCR and NSFR measurements on individual legal entities. An asymmetric treatment would lead to an undesirable increase of the size of required liquidity buffers and long term funding within banking groups (which of course also increases the costs). We fully agree with the Commission that a symmetrical treatment of those transactions is preferable. The Commission describes two alternative approaches for symmetrical treatment of intra-group transactions, one alternative that suits banks managing liquidity centrally and one that suits banks with a more decentralised liquidity management. Since the choice between these set ups depends on local market conditions and the business model applied by the banks we think both alternatives should be possible to choose in order not to unnecessarily limit banking groups' ability to organise their liquidity management effectively.

Question 13: *Do stakeholders agree with the conclusion that for credit institutions with significant branches or cross-border services in another Member State, liquidity supervision should be the responsibility of the home Member State, in close collaboration with the host member States? Do you agree that separate liquidity standards at the level of branches could be lifted based on a harmonised standard and uniform reorganisation and winding-up procedures?*

The principle that it is the home supervisor who is responsible for the supervision even for branches is important. The reason for that is that if it is the host supervisors that have the responsibility banks could end up being regulated under different sets of rules even though liquidity is managed on group-level. Also the fact that the parent company has the possibility to change the liquidity situation of the branch in just a few minutes, advocates for a group-level supervision by the home supervisor.

Question 14: *Comments are sought on the merit of using harmonised Monitoring Tools, either in the context of Supervisory Review or as mandatory elements of a supervisory reporting framework for liquidity risk. Comments are also sought on the individual tools listed in Annex III, their quality and possible alternatives or complements.*

The tools seem to make sense, but it might as well be another set of tools. Perhaps there could be a merit in explaining a number of tools within the framework of guidance from the EBA.

Question 15: *What could be considered a meaningful approach for monitoring intraday liquidity risk?*

Intraday liquidity is of course very important to follow for the bank, but it is difficult for us to see how this could be done in a harmonised way.

Definition of capital

We welcome the objective of the proposal to foster convergence together with the Basel Committee and thereby reducing the current competitive distortions. In light of the ongoing work we would, however, like to stress the importance of not meanwhile implementing guidelines for banks in the member states that go beyond what is required by CRD II (which we believe is the risk if current version of CEBS CP 33 will be in legal force as from year-end 2010).

Question 16: *What are your views on the prudential appropriateness of eliminating the distinction between upper and lower Tier 2, and of eliminating Tier 3 capital?*

We welcome the simplification of the structure of the different layers of capital.

Question 17: *Are the criteria proposed for Core Tier 1, non-Core Tier 1 and Tier 2 sufficiently robust and how might they be improved?*

In general, we welcome the aim of introducing a common definition of capital. However, we do not understand the reasoning behind paragraph 45 and criterion 7 in Annex IV why instruments providing preferential rights for dividend payment on a non-cumulative basis would be excluded from Core Tier 1. We cannot see how a preferential treatment of dividend (in the case that there is available capital) after the decision – and with full discretion – of the shareholders' annual general meeting would change the loss absorbing capacity of the shares. On the contrary our belief is that during the financial crisis such instruments have proven to absorb losses to the same extent as ordinary shares.

To us it seems irrelevant if different classes of equity capital have different precedence in dividends and/or ranking in the event of liquidation. The important factor is that the shareholders collectively are subordinated to all other claim holders, and thus jointly represent the most subordinated class or "the last line of defence" both during going concern and in liquidation. It must be up to the shareholders to decide differences between the different types of classes of equities, which are done at the general meeting. Any such agreement amongst the shareholders leaves their joint relationship toward the rest of the claim holders unaffected, which should be the only concern of the regulators.

To be able to attract equity capital in the event of a financial turmoil it is of greatest importance that different ways to have access to the capital market are available. To offer investors shares with precedence in dividends and/or prior ranking to ordinary shares in liquidation might be one way to ease the supply of equity share capital in a crisis situation. If this type of equity capital is excluded from Core Tier 1 capital it will affect banks access to capital markets, particularly in stressed situations, which will be contrary to the aim to create financial stability.

In the event that a financial institution is in need of capital in a crisis situation and there is no other source than from the government, it would be contrary to the interest of the government (and of the taxpayers) to be forced to accept a rights issue of ordinary shares. This will increase the risk that taxpayers money is used to bail out the original shareholders rather than preserve stability in the financial system. It would in such a situation be preferable for a government to be able to demand shares with a preferential claim in comparison to the

original shareholders in case the rescue action will end up with an orderly liquidation where the shareholders are able to realize a residual claim on the institution.

According to criterion 2 of Annex IV any instrument eligible for inclusion in Core Tier 1 capital must be entitled to a claim of the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation. In case there are different classes of equity capital with different ranking in liquidation it is not obvious if the current wording of criterion 2 would allow all equity classes irrespective of the ranking. We believe a more adequate wording would be: "*Entitled to a claim on any residual amount only after all other claims are satisfied in liquidation reflecting their share in the credit institution. In case the institution has more than one category of capital instruments (i.e. ordinary shares and other capital instruments) with different ranking in liquidation, on a break-up basis the proceeds from the realisation of the credit institution's assets are applied firstly to satisfy all prior claims (e.g. depositors, creditors, holders of subordinated instruments) and any residual amount is distributed between the ordinary shareholders and the holders of such other capital instruments in accordance with the articles of association, or equivalent, of the institution.*"

To conclude we are of the opinion that non-cumulative shares including a preference in dividend should henceforth be eligible for inclusion in Core Tier 1 capital. Any dividend paid on such equity capital is decided on – and with full discretion – by the general meeting. Such equity capital has thus the same loss absorbing capacity in going concern as ordinary shares. We are also of the opinion that different classes of equity capital might have different ranking in liquidation and still be eligible for inclusion in Core Tier 1 capital, as the only relevant distinction in a liquidation situation is between claim holders in general on one hand and the shareholders collectively on the other. This distinction is inherent in the type of claim each of these categories represent.

This is of particular concern for Swedish banks since the proposal might disqualify Swedish preferential shares as Core Tier 1 capital. These shares are according to Swedish legislation equity share capital. In all essential parts such preference shares are equal to ordinary shares (subordinated to all other claims, voting rights as ordinary shares, the general meeting decides on dividend payments implying the same loss-absorbing capacity as ordinary shares, etc). The preference shares might have the feature that they rank prior to the ordinary shares in the event of a liquidation, but are still subordinated to all other claims. The differences between the ordinary shares and the preference shares are agreed on by the holders of ordinary shares at the annual general meeting deciding on the issue of the preference shares. It only affects their relative liaison but more importantly, it leaves their joint relationship toward the rest of the claim holders unaffected.

According to criterion 2 of Annex VI non-Core Tier 1 capital should be subordinated to subordinated debt. Non-Core Tier 1 capital, e.g. hybrid instruments, might be classified as subordinated debt, the second criterion should therefore be rephrased. In criterion 8 of the same Annex we suggest that "*Dividends/coupons shall be paid out **only if there are** distributable items*". Criterion 12 states that the issuing institution should not knowingly purchase the instrument. This should of course not be valid in the event of market making or repurchases of non-Core Tier 1 instruments after prior approval from the supervisory authority. The same comment is valid as regards criterion 8 in Annex VII.

The proposed requirements, which may lead to the fact that non-Core Tier 1 would become non tax deductible would, have a large impact. Since the tax treatment has no connection on the regulatory effectiveness of the instrument, our proposal is that this requirement should be dropped.

Question 18: *In order to ensure the effective loss absorbency of non-Core Tier 1 capital, would it be appropriate under certain circumstances to require the write down of the principal amount of an instrument or its conversion to a Core Tier 1 instrument? To what extent should the trigger for write-down / conversion be determined objectively or at the discretion of an institution or its supervisor?*

For us it is more important that the write down possibility exists and that there should be a principle-based approach rather than detailed rules on whether the trigger should be determined objectively, by the bank or by the supervisor.

If the requirement for an extra loss absorption mechanism is considered as too onerous by investors it may make them less interested in the securities. In a stressed situation this would place non-Core Tier 1 holders in a worse position than common equity holders. We believe that a temporary write down mechanism would be sufficient for non-Core Tier 1 to perform as expected on a going concern basis instead of a specific conversion or write down mechanism.

Question 19: *Which of the prudential adjustments proposed have the greatest impact? What alternative, robust treatments might be considered and what is their prudential rationale?*

The consultation paper takes the view that Core Tier 1 capital should serve as a basis for all deductions from the capital base that need to be made, which will have a considerable impact. We believe the proposed deductions are of different nature, and that this should influence from which layers of capital deductions are made. We would therefore suggest the Commission to assess which items need to be deducted from going concern capital and from gone concern capital respectively, and also consider imposing the going concern deductions from total Tier 1 capital instead of from Core Tier 1 capital.

There should be a consistent treatment of minority interests. If minority interests are not to be included in Core Tier 1, correspondingly minority shareholders' part of RWA should decrease the consolidated RWA. This would in practice mean that consolidation should be made in accordance with the proportional method.

We would also point out that by not applying filter to defined pension fund liabilities there will be a risk of unwelcome volatility in Core Tier 1 capital. The calculation of pension fund liabilities according to IAS19 is done with a very long term perspective but is potentially very volatile as it is based on point-in-time assessments of interest rates. Moreover, the calculation includes assumptions on future payments to which there are no current obligations to meet. Liabilities are normally based on explicit contracts defining the obligations to pay while the calculated pension fund liabilities have another nature. We would therefore suggest the Commission to consider a regulatory treatment of pension fund liabilities in the CRD that aims to reduce unwelcome volatility in Core Tier 1 capital. Even though the "corridor approach" under IAS19 is expected to be removed an alternative could be a similar approach

from a regulatory perspective. Due to differences between member states in pension fund systems there might however be a need of national discretions related to these issues.

The requirement that an institution's investments in own common shares should be deducted will be a very burdensome requirement since institutions also are required to look through holdings of index securities to deduct exposures to own shares. Our suggestion is to rephrase the second bullet point in Annex V to "*Institutions shall look through **material** holdings of index securities...*"

The same comment is valid for investments in the common shares of certain banking, financial and insurance entities, i.e. our suggestion is to rephrase the last bullet in this section to "*Institutions shall look through **material** holdings of index securities...*"

***Question 20**: Are the proposed requirements in respect of calls for non-Core Tier 1 and Tier 2 sufficiently robust? Would it appropriate to apply in the CRD the same requirements to buy-backs as would apply to the call of such instruments? What restrictions on buy-backs should apply in respect of Core Tier 1 instruments?*

Financial institutions need the flexibility of buy-backs in order to achieve an efficient management of their Tier 1 instruments and to strengthening the liquidity in the instruments issued. Therefore the institutions should, at least, have the possibility to get the general consent from the competent authority to freely buy and sell their own Tier 1 instruments within given limits, with reference to market maker commitments, market conditions, level of capital, Tier 1 ratios, capacity to expand or reduce risky activities etc.

Buy-backs of hybrid Tier 1 securities are different from call options as they represent a transaction between two consenting parties, as opposed to the unilateral right to redeem of a call option. Moreover, redemptions are done at par value while buy-back transactions are done at prevailing market rates which in case redemption could be made under par value would result in a realised gain that increases core capital. Consequently, the net effect of a buy-back might result in a smaller decrease of the Tier 1 capital than a corresponding call does, and at the same time the quality of the remaining Tier 1 would increase. Therefore we believe that the requirements on buy-backs in such cases need not be as restrictive as the requirements that apply to a call of such instruments.

We firmly believe that core capital instruments are part of the basic strategic business of an entity and that the owners should be free to decide in such matters at the general assembly, hence core capital instruments should not be subject to buy-back restrictions other than what is already prescribed by national corporate law. At least buy-backs of core capital instruments should be treated in the same way as ordinary, and extra, dividends.

***Question 21:** What are your views on the need for further review of the treatment of unrealised gains? What would be the most appropriate treatment of such gains?*

We would favour the original proposal, i.e. that both unrealised gains and losses should be treated in the same way for regulatory purposes as they appear in the balance sheet for accounting purposes. In any case, we believe that the treatment of unrealised gains from

instruments that are traded in liquid markets, or where the fair value can be objectively verifiable, should be treated symmetrically with unrealised losses.

***Question 22:** We would welcome comments on the appropriateness of reviewing the use of going concern Tier-1 capital for large exposures purposes. In this context, would it be necessary to review the basis of identification of large exposures (10% own funds) and the large exposures limit (25% own funds)?*

We can understand the suggestion from the Commission to use the going concern capital for large exposure purposes. However, this would require a recalibration of the limits since it otherwise would be a material change of the actual size of large exposures that has been decided on in CRD II. Changing the denominator from total capital to Tier-1 capital would increase the number of counterparties being reported as large exposures, and it could mean that actual exposures would need to be reduced, which would reduce the ability for banks to lend. Since the capital requirement for Tier 1 capital today is 50% of the requirement for the total capital base, the limits for large exposures should be doubled in order to correspond to the change of the denominator for measurement of large exposures. Thus, a large exposure should therefore be defined as an exposure above 20% of the Tier 1 capital and the limit for the maximum size of an exposure that is allowed should be 50% of the Tier 1 capital.

***Question 23:** What is your view of the purpose of contingent capital? What forms and triggers would be most appropriate?*

In our view the possibility to use contingent capital would increase the banks possibility to capitalise, since this could attract a wider range of investors. Therefore we support the Commissions' work to further reflect on the potential role and characteristics of contingent capital. As for the question on the forms of triggers we are of the opinion that those should be defined by the banks under the condition that conversion is made during going concern.

***Question 24:** How should the grandfathering requirements under CRD II interact with those for the new requirements? To what extent should the grandfathering provisions of CRD II be amended to bring them into line with those of the new capital requirements under CRD IV?*

Shouldn't it be the other way around? The grandfathering rules in CRD II should be followed and the grandfathering rules in CRD IV should be adjusted to this. The grandfathering rules in the CRD II could be the model for the rules in CRD IV, even though they need to be adjusted to include grandfathering of instruments also in other layers of capital.

Leverage ratio

We strongly oppose an introduction of a non risk-based measure as the leverage ratio. We are of the opinion that an introduction of a leverage ratio, to complement the capital adequacy measure, would be an improper way to try to prevent future financial crises. A leverage ratio could have severe effects on the functioning of the banking system, while it would not have any positive effects with respect to achieving more responsible risk-taking in the banking sector. The proposal may have serious credit-squeezing effects, and in particular provide an obstacle to the funding opportunities for low risk operations, such as loans to mortgage customers, the public sector and highly creditworthy companies. Since the leverage ratio is a non risk-based measure it would hit low risk banks (such as retail banks) especially hard. It would also reduce the incentives to manage risk in a proper way. Implementing the proposal would most likely immediately have this kind of effect, even though its implementation may be far ahead.

The leverage ratio gives incentives to manage credits without considering risk. Thereby it reverses many of the positive results of the introduction of Basel II. Basel II has led to a more differentiated pricing of risk and lower interest margins for low risk operations such as mortgage loans and loans to highly creditworthy companies. The spread between the price of low risk credits and credits for high risk projects has never been wider than at present. This means that credit institutions function better in their role of converting savings into financing on behalf of their customers.

A leverage ratio will not remedy any of the problems that gave rise to the crisis. On the contrary, it will give an even stronger incentive to opt for high risk rather than low risk lending. It will also increase the incentive to remove exposures from the balance sheet, for example through securitisation. The problems with securitisations, where credits had been sold by banks and converted on several occasions so that the risk became impossible for investors to assess, were one of the main causes of the current crisis.

It is mainly operations that are low risk, but are a major component of banks' balance sheets, that will be affected by a leverage ratio. Under the proposed regulations, the capital requirement for these operations would be many times higher. To a great extent, these are operations that are vital to the national economy, for example:

- Mortgage loans to financially sound households. In Sweden this type of lending has been low risk operations for banks during the past decades. As a result, they also have a low capital requirement in relation to the size of the exposures.
- Holdings in government securities and other state or municipal loans. Due to the more or less non-existent credit risk, these are not subject to any capital requirement at all under the current capital adequacy regulations.
- Repo operations. Repos are loans that are guaranteed with securities – chiefly government securities. Due to the high quality collateral and other well-developed risk management mechanisms, the capital requirement for repos in the current system is very low. On many markets, repos are a key part of government securities trading, as they enable banks to fund their government securities trading efficiently. In smaller currency areas such as Sweden, where government securities trading is usually run as a market maker system, repo operations are a condition for strong liquidity in government securities trading. Thus, repos help to reduce government funding costs.

- Loans to highly creditworthy companies with low debt levels and high quality collateral.

Consequently, regulations that punish low risk operations cause such operations to be moved off the balance sheets of regulated institutions. The US financial market, which was long governed by capital regulations including a leverage ratio, is a clear example of this. Large creditworthy companies fund themselves almost exclusively on the bond market, and mortgages are securitised. This has both advantages and disadvantages, and the current crisis has shown some very clear disadvantages. One is that securitisation often can involve dubious incentives for the market players, in that the securitising players attempt to sell off credits without passing on the responsibility for the long-term risk. Another disadvantage is that it is difficult for a company that is dependent on market financing to obtain continued funding during times of stress. The market tends to be extremely risk-averse in such times, and will not offer financing at any price. This will put high pressure on banks to provide increased financing, which they might not be prepared to. Therefore, this market structure increases the volatility of the market and can lead to consequences for customers and the real economy. The development of the US mortgage market during the recent crisis has illustrated this very well. Even creditworthy customers with low loan-to-value ratios were unable to get mortgage loans on the securitised private credit market. The market still only works through the government sponsored mortgage institutions (Fannie Mae and Freddie Mac).

The reaction to move assets from the balance sheet, through securitisation, is mainly an initial response to the introduction of a leverage ratio limitation. This could cause a disturbance of the financial markets as many banks will issue securitised assets at the same time. As time goes by, the leverage is expected to give rise to a new market for low risk lending outside of the regulated financial sector (a shadow banking system).

With the construction and the levels for a leverage ratio discussed so far, there is a risk that the proposal will have a credit-squeezing effect on the European economy. Just as for other capital requirements, it will be necessary to maintain capital at a certain level above the formal requirement, in order to manage temporary fluctuations.

Even if the date for introducing new regulations is set several years in the future, a decision about such regulations will have a more or less immediate effect on the supply of credits. Since it takes a long time to make redistributions of this magnitude, it will be necessary for European banks to reorient their operations as soon as the decision-process for the new regulations is under way.

In addition, there is a danger that a leverage ratio will be counter-productive in terms of increasing demands on the banks' management of liquidity risks as a result of the crisis. Good liquidity management is conditional upon banks having a substantial portfolio of liquid assets – mainly low risk securities – in order to manage strains on liquidity. As discussed above, a leverage ratio will give the banks strong incentives to reduce their holdings, and thus the regulations will be self-conflicting. We therefore strongly support the option mentioned in Annex VIII, that the liquid assets included in the banks' buffer to cover the Liquidity Coverage Requirement should be excluded from the total exposure measure when calculating the ratio.

If a leverage ratio is introduced, despite the very negative effects it would have, the rules should not stipulate an appropriate level of the ratio. Rather it should only suggest that this measure can be used in the dialog with banks in pillar 2. This would probably reduce the risk that investors put excessive weight on the measure, and make it clear that the Basel II capital requirements are the important capital measures. It would also underline the fact that banks may have different leverage ratios, depending on their business models, and that it is changes of the ratio that may be a warning signal, rather than the level of the ratio itself.

Even if the leverage ratio is introduced as a pillar 2 and/or pillar 3 measure, there is still a risk that investors might see it as an important capital ratio – since this ratio has been defined and sanctioned by the regulators – and that banks will need to adapt to this. Many of the consequences that are discussed above might thus come to effect even if it is not a binding pillar 1 requirement.

If a leverage ratio is to be implemented it is important that it also includes off-balance sheet-items. If off-balance sheet items are not included in the ratio it could encourage regulatory arbitrage as it would provide an incentive to make use of off-balance sheet vehicles and instruments. Furthermore, it is also important that a possible introduction should be implemented in a harmonised way on a global level to ensure a level playing field.

We support the alternative, mentioned in paragraph 94, to permit regulatory netting rules set out in the CRD for repurchase transactions and securities lending transactions. The accounting rules on repos are most likely about to change and such a change would mean that the ratio would change drastically without an actual change of conditions within the banks. Another aspect is that banks might be forced to stop using repos as a source of short term funding in order to deleverage the balance sheet. This could create a liquidity crunch as the repo market is an important tool for ensuring liquidity in the market.

The possible introduction of a leverage ratio should be assessed in relation to all other regulatory proposals and changes. Many of the changes will result in higher capital requirements and the combined effects must be carefully analysed. In our opinion it is better to regulate the specific areas where it is considered that the Basel II (implemented via CRD) has failed to measure risk in a correct way, rather than to introduce a crude measure as the leverage ratio.

One important issue that we would like to highlight regarding the current QIS is that there are no questions on the leverage ratio as regarding the impact on the level of legal entities. It is important that the Commission's conclusions from the answers that regards the consolidated level are not transferred to the legal entities. Leverage ratio requirements on legal entities would prevent banking groups from managing capital in an efficient way and banks would have to transfer capital within the group without this being required from a risk perspective. It might also follow as a consequence that the group would have to raise more capital to be able to fulfil the requirement for each legal entity, even though the group would not need more capital.

In summary, the possible introduction of a leverage ratio will have grave consequences for the function of the European credit market – to efficiently transform savings into capital which is used where it is most needed in the economy. Low risk operations will be hit particularly hard, e.g. mortgage financing, government securities trading and lending to highly

creditworthy companies. At the same time, a leverage ratio will not help in any way to reduce the risk of financial instability in the future. On the contrary, the proposed regulations will produce a greater incentive for lending at higher risk, which will increase the risk of financial instability.

***Question 25:** What should be the objective of a leverage ratio?*

Leverage created incremental value losses during the financial crisis because stressed activities were funded with short term liabilities. The regulators work to improve the risk sensitive Basel framework (to better take into account those activities that have proven not to be properly assessed) and introduce a liquidity regulatory regime are supported. The leverage ratio does not bring any additional value in this respect, as these other improvements are much better aimed to improve financial stability. The leverage ratio (especially in the proposed form) is a too simple measure to be used for financial stability purposes and to be used as the single tool to restrict leverage.

We are of the opinion that the leverage ratio as a back-stop already can be used within the pillar 2, if the supervisors want to use it as an indicator of leverage. However, to us, it does not make sense to regulate this particular tool when there are a number of different tools that the supervisors might use in this aspect. We are also of the opinion that the leverage ratio will not be able to be used to prevent future financial crises. If a leverage ratio would be introduced we see it as important that it is implemented in a flexible way. To us the possible application of the ratio is that it could be used in pillar 2 to look at changes in a specific bank's leverage. A sudden change in the ratio could be an indicator that action from the supervisors are needed and that the leverage might need to be decreased.

Another aspect is that it will be very difficult to harmonise a leverage ratio as suggested. One of the reasons for this is that the accounting frameworks are different in the way they treat off-balance sheet-items. Even within the IFRS there are differences in how the off-balance sheet-items are treated between different countries. This will make the ratio less useful as one of the objectives should be to compare the ratio between banks. If the ratio are to be used in any way it would therefore be more useful if it were not that prescriptive and used as one of several indicators in pillar 2.

***Question 26:** Which element of going concern capital do you consider would be a more appropriate basis for the leverage ratio? What is you rationale for this view?*

To us, the most appropriate would be to use total Tier 1 capital as the basis for the leverage ratio. The reason for this would be that the introduction of a leverage ratio as a supplementary measure will in fact increase the complexity of the regulatory capital framework, as several measures must be managed simultaneously. If different capital definitions are used in the different threshold calculations, it will increase the complexity and decrease the bank's flexibility to manage the different regulatory thresholds. To use Core Tier 1 would force the banks to issue new shares when in need for capital. This would take too much time and it would also restrict the possibility to obtain capital from a wider range of investors.

***Question 27:** What is your view on the proposed options for capturing the overall extent of an institution's derivatives business in the denominator of the leverage ratio?*

We are of the opinion that netting should be allowed. The reason for this is that this would be more harmonised across jurisdictions and that it would capture risk in a more correct way. The proposed treatment of netting (i.e. its complete non-recognition) is a radical approach that is inconsistent with the trend of progress in the industry in the last 20 years, leading to an excessively penalizing treatment of assets such as derivatives and repos. In particular, the lack of recognition of legally enforceable netting and margin agreements, including those under ISDA standard agreements, goes against long and established industry practice. It is not sound to deny the recognition of netting simply because its application across jurisdictions raise technical question of complex nature. Rather, the Commission should undertake the necessary analysis to implement a common set of regulatory netting rules (as currently determined under Basel II) which would be applied to assets before they are subject to the proposed leverage ratio. The Commission should of course continue to advocate adoption by the accounting standard-setters of consistent and appropriate netting rules.

The non-recognition of netting would deny banks the risk-reducing benefits of standardised agreements which would in turn create disincentives for sound risk management. The implications for markets in derivatives, repos and securities financing, where netting is of the essence, would be simply devastating and would likely push much of these activities to unregulated markets.

***Question 28:** What is your view of the proposed approach to capturing leverage arising from credit derivatives?*

No particular comments.

***Question 29:** How could the design of the leverage ratio ensure that it would act as an effective constraint only in benign economic conditions?*

To design the leverage ratio as an effective constrain in benign conditions is, in our opinion, impossible without considering the risk. On the contrary, the leverage ratio may rather limit banks behaviour in a downturn, than under a benign business cycle. The reason why this may be the case is that banks will be able to operate close to the minimum level when the economy is booming, since the risk for losses that consumes the capital is low in such times and investors are less worried about the capital position of banks. In a downturn however, credit losses may be so large that they actually leads to a consumption of capital, meaning that the leverage ratio is getting worse. Even if the losses have not yet become so high, the risk for increasing losses may lead to that investors will fear that banks will not be able to keep their leverage ratio at a stable level, or even demand that banks increase their leverage ratio. This will mean that banks will have to reduce their balance sheet (if they do not want to issue new capital), which means that the leverage ratio would become a procyclical measure. In essence, the leverage ratio will be procyclical to the same extent as Basel I capital ratios were procyclical. In practice, it is therefore likely that the leverage ratio will rather be a pro-cyclical than a countercyclical measure.

Question 30: *What would be the appropriate calibration of a leverage ratio?*

In our view it is important that the ratio does not reduce or eliminate the incentives which have been embedded into the CRD. Banks should not be forced or incentivised to manage according to the leverage ratio, but according to the risk measured by Basel II and the internal economic capital models. Therefore, the regulation on a leverage ratio should only define the measure, not prescribe a minimum level. An appropriate level of the leverage ratio is very much dependent of the business model of a bank, therefore it is not possible to set a level that actually is appropriate for all banks. Rather, supervisors should follow the change in the leverage ratio, not focusing on the actual level. The calibration of the ratio should make sure that it does not hinder stable banks, but would make it possible for supervisors to understand when a certain bank might need more supervision due to the fact that the ratio has changed.

Counterparty credit risk
The Commission proposes that the model based exposure value used to determine counterparty credit risk should be the maximum of (1) the effective EPE using the current market data and (2) the effective EPE using the three year period that includes the one year stressed period used for stressed VaR calculations. The motivation for the proposal is to reduce the perceived pro-cyclicality of the current regime, on one hand, and take into account the full impact of wrong way risk, on the other.

We are of the opinion that the distinction between pillar 1 (economically motivated minimum capital) and pillar 2 (stress testing among other things) is very valuable for the sake of conceptual clarity. Therefore, we do not agree to the idea of stressing modelling inputs under pillar 1. This has a tendency to make probabilistic interpretation of capital useless. Under pillar 1, institutions should be allowed to use their best estimates for modelling input parameter values.

We are of the opinion that the Commission should reconsider the proposed stressing framework under pillar 1 in order to avoid a situation where all input parameters (PD, LGD, and EAD) into credit risk models are stressed at the same time. Stressing all risk parameters at the same time will overstate the risk in a stressed situation since the risk parameters are not fully correlated. It is not likely that the EAD reaches its peak at the same point in time as the LGD and PD reaches their peaks.

The Commission has stated that the stressed exposure value should take into account general wrong way risk. Wrong way risk was originally intended to be captured trough the alpha factor used for determining the exposure value. Our understanding is that the alpha factor covers both general and specific wrong way risks. This alpha factor – set in the regulation (a value of 1.4) as well as the floor for own estimates (a value of 1.2) – needs to be recalibrated in order to avoid double counting of general wrong way risk, if the Commission decides to introduce the stressed EPE framework.

We do not support the proposal to introduce a separate PD requirement for counterparties that are highly leveraged and for counterparties whose assets are predominantly traded assets. It is common that bank's rating models already accounts for leverage. Thus, highly leveraged counterparties are already today assigned a higher PD and therefore also a higher capital requirement. The Basel II rules are not prescriptive in details in other ways when it comes to how banks make their risk classification in the PD dimension. If anything, they are quite open to what parameters that may be valid. It seems awkward to have a detailed regulation for these very particular counterparties.

***Question 31**: Views are sought on the suggested approach regarding the improved measurement or revised metric to better address counterparty credit risk. With respect to suggestion to incorporate - as an interim measure - a simple capital add-on by means of calculating the loan-equivalent CVA charge, views are sought on the implications of using VaR models for these purposes instead.*

We understand the idea of a capital charge on credit valuation adjustments risk (CVA risk). However, we do not support the proposed methodology for the CVA risk capital charge.

Generally, CVA risk on an individual counterparty is subject to a) changes in exposure through changes in market parameters affecting the mark-to-market values of the transactions with the counterparty as well as b) changes of the credit quality of the counterparty. Thus, the pure market risk of an increased exposure value will affect the CVA. In the proposal, the expected positive exposure – as is common to use in the actual CVA calculation – is approximated with a bond equivalent. A direct consequence is that the very complex risk underlying the exposure value is reduced to a very simple single currency interest rate risk. The CVA in a bank is sensitive to all underlying factors determining the total portfolio, in a non-linear fashion. Many banks are able to quantify the market risk of the CVA and aggregate this with the similar market risk in the trading book.

Furthermore, many banks have set up hedging of the market risks that are embedded in the CVA. The standalone nature of the calculation of CVA VaR does not account for the hedging of market risks embedded in the CVA. In fact, in most cases hedging of the market risk component of the CVA will actually increase capital requirement because the hedge transactions will typically be included in the "normal" VaR and hence subject to a capital requirement as an un-hedged position. This type of treatment does not give incentive to manage the embedded market risk. It actually punishes attempts to manage the risks.

Our suggestion is to allow banks to use their internal risk measures for embedded CVA risk and allow aggregation of the embedded CVA market risk with similar market risks in the bank and hereby giving incentives to manage the risk.

It is our view that there is at least one element of double accounting when combining the proposal with the existing capital charge for counterparty risk (for default risk). We understand that the 10 day VaR figure for the bond equivalent method (which is considered to be too conservative in itself) should be multiplied with 30 (3*5*2 for the regulatory VaR multiplicator, time scaling multiplicator and stressed VaR respectively), which seems to give an outrageous result and includes elements of double counting. We have identified double counting in the following areas, which are described below:

- Multiple VaR calculations for CVA risk (regular VaR and stressed VaR)
- CVA not reflected in EAD for default risk
- CVA risk already taken into account in the IRB formula
- Multiple time scaling factors in the CVA risk calculation.

The document proposes that the capital charge for CVA risk should include both the regular VaR (for general and specific risk) and the stressed VaR. The CVA risk is therefore counted twice. We are of the opinion that the capital charge for CVA risk should be determined either as the regular VaR or the stressed VaR – not both.

The Commission should also clarify how the CVA should be treated when determining the exposure value that is used for determining the capital charge for default risk of OTC derivatives. Our view is that the CVA should be reflected when determining the exposure value for counterparty credit risk. On each transaction there is a market value calculated without taking credit risk into account. Let's say that is 100. The CVA is an adjustment to the market value, which reflects the price of the counterparty credit risk. Assume that the CVA is 20. This means that the true value of the transaction is 80 = 100-20. This is the value that is

booked in the balance sheet. This value (plus an add-on for potential future exposure) should be used in the CEM method to determine the exposure to counterparty risk.

Furthermore, it should also be clarified whether the maturity adjustment in the IRB formula should continue to be used for OTC derivatives, since the maturity adjustment is an additional capital requirement for future downgrades (downgrades are more likely in case of long-term credits and hence the anticipated capital requirements will be higher than for short-term credits).

We would also like the Commission to clarify if the CVA risk charge shall be calculated by using the usual VaR multiplication factor applied in the market risk framework. It is stated in the instructions for the QIS that a VaR multiplier should be used for the purpose of the QIS exercise. It is known that the VaR multiplier contains a time scaling factor (i.e. a factor that converts the holding period from 10 days to a longer time horizon), as well as some other components. However, the time scaling is already taken into account explicitly in the CVA VaR calculation (by the multiplication of 5) and it is seems therefore as the VaR multiplier double counts the time scaling to some extent. Furthermore, there are some shortcomings with the square-root-of-time formula, which shall be used to convert the 10 day holding period to one year according to the proposal. Our suggestion is that these shortcomings are reviewed (e.g. that the formula does not address convexity) and that an alternative method is considered.

The Commission proposes that the proxy spread used to determine the CVA for fair-value accounting purposes must be used as the spread of the bond, whenever the CDS spread is not available. We support this important principle as we believe that the risk embedded in the CVA is best assessed by the factors that determine the CVA.

We are of the opinion that the suggested loan-equivalent approach for calculating CVA risk is suitable for those banks that cannot calculate CVA in their daily mark-to-market valuations for derivatives book. The banks having this ability should have an option to calculate a genuine VaR figure against the CVA portfolio under its chosen VaR methodology.

Question 32*: Stakeholders are invited to express views on whether the use of own estimates of Alpha should continue to be permitted subject to supervisory approval and indicate any evidence in support of those views.*

It is reasonable to impose a capital charge for specific wrong way risk if this is not currently taken into account in the alpha parameter. However, double counting of specific wrong way risk should be avoided if specific wrong way risk is already taken into account in the internal model (whether using an IMM exposure method based on peak exposure or alpha times effective EPE).

We support the possibility of allowing banks to model alpha and subject the result for supervisory approval. Alpha depends on portfolio specific attributes and, therefore, standard regulatory figures cannot be seen to have comparable validity.

***Question 33**: Views are sought on the suggested approach regarding the multiplier for the asset value correlation for large financial institutions, and in particular on the appropriate level of the proposed multiplier and the respective asset size threshold. In addition, comments are sought on the appropriate definitions for regulated and unregulated financial intermediaries.*

In general, we acknowledge the need for measures to account for and reduce systemic risk. We understand that financial institutions are more correlated than non-financial institutions in various sectors and that there is a rationale for increasing the asset value correlation factor for financial institutions. However, imposing a higher correlation factor for financial institutions should be done in a careful manner as this measure will significantly affect inter-bank lending, which could have a detrimental effect on liquidity in the inter-bank market. As witnessed by the financial crisis a highly liquid inter-bank lending market is a key to sustained financial stability. The proposal will lead to higher costs and less efficient inter-bank markets, which eventually also will affect the possibilities and costs for non-financial customers. This will have an impact on the economic growth.

The proposal is burdensome to implement due to that it does not rest on the current framework for asset classes. If the Commission decides to go forward with this proposal, we ask the Commission to implement the increased correlation on the asset class Institutions only and not also to a subset of the asset class Corporate. To define the non-financial institutions, highly leveraged entities or similar institutions, that the Commission is seeking to cover, is almost impossible. It will definitely lead to quite arbitrary judgements. Moreover, the administrative burden and IT costs to create a new asset class as well as new RWA calculations are estimated to be a considerable issue for many banks.

In case the proposal is implemented, we believe that there is no rationale for an additional capital requirement to address the interconnectedness of systemically important financial institutions, since such a capital charge would double count the correlation between institutions.

The document states that the proposed increase of the asset value correlation factor is calibrated based on empirical work and that further studies will be undertaken in order to verify the proposed levels. It would be of great value if the Commission could share more information on these empirical studies in order to enable the banking industry to assess whether the proposal is reasonable. It is important that the asset value correlation is measured under normal economic circumstances, not during an economic downturn. The IRB formula performs the task of converting the institutions internal estimates of a normal PD to a PD that reflects stressed economic conditions. Using asset value correlations, based on stressed conditions, in the IRB formula would double count (or at least overstate) the stressed PD (i.e. the conditional PD that reflects the default rates given an appropriately conservative value of the systematic risk factor).

***Question 34**: Views are sought on the suggested approach regarding collateralised counterparties and margin period of risk. Views are particularly sought on the appropriate level of the new haircuts to be applied to repo-style transactions of (eligible) securitisations. In this context, what types of securitisation positions can, in your view, be treated as eligible collateral for purposes of the calculation of the regulatory requirements? Any qualitative and/or quantitative evidence supporting your arguments would be greatly appreciated.*

We support the proposed changes. It is reasonable that higher volatility adjustments are used for financial collateral based on securitisations. However, a number of measures are introduced to restore the securitisation market. Therefore, the haircuts for financial collateral based on securitisations should be recalibrated when the securitisation market recovers. Also it should be taken into account that, in general, there are various types of securitisation and, hence, need for differentiated haircuts.

We believe that collateralisation of OTC derivatives contracts between financial institutions is important. Better collateralisation of the financial system is a key point to reducing contagion in crisis situations and consequently systemic risk. Hence we support better collateral management processes in the industry and the collateralisation of all inter-dealer OTC derivatives trades.

In this area much work is being done and commitments are made by the Industry, e.g. in the ISDA and the Operations Management Group letter of 2 June 2009 to international regulators. As flexible industry driven changes often provide better results than rigid regulatory demands, improvements should be industry driven rather than forced through capital requirements. The proposal is, in our view, too prescriptive and rigid. We would appreciate a higher degree of freedom to find own solutions, suitable to the individual bank.

***Question 35**: Views are sought on the suggested approach regarding central counterparties and on the appropriate level of the risk weights to be applied to collateral and mark to market exposures to CCPs (on the assumptions that the CCP is run to defined strict standards) and to exposures arising from guarantee fund contributions.*

We also support the continued use of a zero risk weighting (i.e. no capital requirement) of contracts with CCP clearing. CCP clearing has the important benefits of mitigating credit and operational risks. Also, we believe that proper regulation to ensure safe and sound risk governance and solid financial backing of CCPs, in order to reduce potential systemic risk implications, should be a prerequisite for having a risk weight of zero. Also indirect clearing members should face a zero-risk weighting when they have a direct claim on the CCP equivalent to that of a direct clearing member.

With the zero risk weighting for CCP cleared contracts there is already a clear incentive to use CCPs. Therefore, we do not see the need for higher, punitive capital charges for contracts only because they are not CCP cleared.

Not all counterparties have the ability to use a central clearing of derivative contracts. For instance, many of the corporate customers do not have the cash management systems necessary to engage in day to day margining. Thus, a large part of the derivative positions cannot be cleared centrally even though the bank has an incentive to do so.

Furthermore, product standardisation is a necessary, but not sufficient, condition for a contract to be eligible for CCP clearing. As the customers' needs of hedging are very individual, standardised contracts will not help them to fully hedge their individual risk. Therefore, punitive capital charges for bilateral and tailor-made contracts will increase costs for the customers and perhaps even force banks to abandon part of the tailor-made OTC derivatives markets. This will leave the customers with risks they do not want and cannot manage effectively. This could have serious consequences for the real economy and harm economic growth.

Question 36: *Views are sought on the risk management elements that should be addressed in the strong standards for CCPs to be used for regulatory capital purposes discussed above. Furthermore, stakeholders are invited to express their views whether the respective strong standards for CCPs to be used for regulatory capital purposes should be the same as the enhanced CPSS-IOSCO standards.*

We support proper regulation to ensure safe and sound risk governance of central counterparties in order to reduce potential systemic risk implications and as a prerequisite for having the zero risk weight.

The European Commission has announced a proposal on a European Market Infrastructure Legislation (EMIL) by mid 2010. EMIL is expected to include regulation of CCPs, including provisions on proper CCP risk management to be fulfilled in order to achieve authorisation to CCP clearing. In order to be consistent, standards on risk management used for regulatory capital purposes should be the same as in EMIL. It is also important that rigid capital requirements are set up for CCPs, in order to avoid the risk that central clearing leads to an inappropriate risk concentration within the CCP, thereby increasing systemic risk.

In our view it would also be natural to build on the CPSS-IOSCO standards in the coming legislation.

Question 37: *Views are sought on the suggested approach regarding enhanced counterparty credit risk management requirements. Do the above proposed changes to the counterparty credit risk framework (in general, i.e. not only related to stress testing and backtesting) address fully the observed weaknesses in the area of risk measurement and management of the counterparty credit risk exposures (both bilateral and exposures to CCPs)?*

In general, we believe that further work is needed to develop the proposals on counterparty credit risk to make them workable and appropriate for the risk that they are aiming to mitigate. At present, the proposals could damage the inter-bank markets and the possibilities for corporate customers to conduct business and hedge risk which will hamper economic growth.

Further analysis is needed on derivatives as several proposals are punitive to derivatives and seem to be overlapping. In addition to the proposal on risk coverage, the new market risk framework in CRD III will also increase the risk estimate of derivatives. Furthermore, the proposal for a leverage ratio might be grossing-up derivatives, adding higher costs to the use of derivatives. As a result, the important role of OTC derivatives for corporate risk hedging

purposes is in danger and we asks the Commission to perform an instrument-wise analysis considering all the changes to the OTC derivatives in order not to harm risk mitigating possibilities and hence economic growth.

On the proposals on counterparty risk management, we believe that the proposals are too prescriptive and rigid. We would appreciate a higher degree of freedom to find own solutions, suitable to the individual bank. As it is written now there is a risk that risk management will become a box-ticking exercise instead of improving the management of risk.

Countercyclical measures

We support the Commission's ambition to tackle the framework's cyclicality, even though it should be emphasised that the present framework already contains tools for managing cyclicality. In particular, the thought behind the present framework has been that banks should take the potential cyclicality of the capital requirement into account in their capital planning process, and through stress-testing see to that sufficient buffers exist even in a severe downturn. In the pillar 2 process, this process and its outcome should be assessed by the supervisor. This may not have worked in some instances, but still this is the preferable way of dealing with the remaining cyclicality in pillar 1 according to our opinion. This approach has the clear advantage of making it possible to deal with particularities within each bank, such as the portfolio composition and the degree of cyclicality within the rating system. Another way to deal with cyclicality within the present framework, and specifically the issue of RWA cyclicality, is to allow banks to transform their rating system output into through-the-cycle measures that stabilizes pillar 1 RWA. This has been allowed by many authorities, including the Swedish supervisory authority, already within the current regulation.

In order for counter-cyclical buffers to work as a measure against cyclicality, they must be just buffers, i.e. reserves that actually can be drawn on during bad times. If the buffers were to be expressed as a particular target or value for the pillar 1 capital ratio, as in the Commission proposal for capital buffers, there is a big risk that this new target will be seen as a new floor by the market. If such a pillar 1 approach is chosen, in order for measures to function as a measure against cyclicality, it is much better if the buffers can be incorporated in the measure of RWA or own funds.

Through-the-cycle provisioning for expected credit losses

Question 38*: The Commission services invite stakeholders to perform a comparative assessment of the three different methods (i.e. ECF, incurred loss and IRB expected loss if it could be used for financial reporting) for credit loss provisioning from 2002 onwards based on their own data.*

The ECF approach means building a whole new framework alongside the current accounting rules and IRB system. Therefore, the time is too short to be able to do a thorough work on this. Also, it would be impossible to obtain data from 2002 for ECF.

Question 39*: Views are sought on the suggested IRB based approach with respect to the through-the-cycle provisioning for expected losses as outlined above.*

Out of the three approaches, we strongly support the IRB expected loss approach. Like the Commission, we see several merits using this approach. These systems are already set up within the banks and they are subject to rigorous quality controls both internally within the banks (internal audit, quantitative and qualitative validation) and externally by supervisors and to some extent external auditors.

As stated we believe that, to have the intended effect, counter-cyclical measures should affect the pillar 1 capital ratios. This does however not necessarily mean that they must effect the profit and loss statement. One can think of a solution where regulatory Tier 1 is affected by what in essence will have the same effect as dynamic provisioning but without passing the

profit and loss statement. In this respect, it is important to point out that the proposal by the Basel Committee to distract the EL component 100% from common equity is a significant step towards this kind of solution.

However, if the IRB based approach is introduced, it is important that this measure is synchronized with the IASB:s initiatives on ECF, so that similar but still different systems does not need to be set up and used in parallel. It seems very costly and also redundant to have these systems working in parallel.

Capital buffers and cyclicality of the minimum requirement

We oppose the use of the capital buffers. We are especially concerned about how the banks would be able to use these buffers in stressed situations. The recent crisis has shown that banks, by the market, have been expected to hold more rather than less capital in times of economic stress. This leads us to believe that it would be difficult for banks to use these kinds of capital buffers. If the buffers are not able to be used in stressed situations they would lead to an increase of the cyclicality rather than being a buffer against cyclicality.

***Question 40**: Do you agree with the proposed dual structure of the capital buffers? In particular, we would welcome your views on the effectiveness of the conservation buffer and the counter-cyclical buffer, separately and taken together, in terms of enhancing the resilience of banking sector going into economic downturn and ensuring the flow of bank credit to the "real economy" throughout economic cycle.*

It is our opinion that these capital buffers would mean that there in practice would be a new minimum capital requirement. We think this is the wrong way to deal with this and that it instead should be dealt with under a flexible pillar 2 approach to allow for discussions between the supervisory authority and the individual bank. If this would not be dealt with under pillar 2 it would mean that ICAAP/SREP is given up and that the decision instead is only made by the supervisory authority, without any dialog with the bank. It is our experience that the dialog within pillar 2 has worked very well between the Swedish banks and the Swedish supervisory authority.

The possible introduction of capital buffers would mean that the capital management of the bank would be restricted even though the bank has capital above the capital requirements. Already, banks tend to have two additive buffers of capital; firstly the minimum requirement and secondly a buffer above the minimum requirement that is big enough to ensure that there is a very small likelihood that the bank would reach the minimum requirement. A new limit for the conservation buffer would mean that banks would need to add a third buffer, so that the bank is to some extent certain that the limit for the conservation buffer will not be reached. And upon all this, the capital requirement in itself is calculated with many layers of conservativeness, in order to have a safe and sound capital measure. Reducing the dividends pay-out for banks would also make banks equity less competitive and attractive. At the same time the suggested new narrow capital definitions and the different new rules on capital requirement will force banks to raise more capital of this kind.

***Question 41**: Which elements should be subject to distribution restrictions for both elements of the proposed capital buffers and why?*

None. It is our strong opinion that it must be up to the shareholders to decide on the distribution of capital. It should be kept in mind that the minimum capital requirement already in itself is a threshold that the bank would hit some time before becoming bankrupt. The supervisory authorities have many measures that they can make use of before and when the limit is breached.

***Question 42**: What is the appropriate timing – following the breach of capital buffer targets – for the restriction to capital distributions to start? Should the time limits for reaching capital buffer targets be determined by supervisors on a case-by-case basis or harmonised across EU?*

As we see it, the time limits for reaching capital buffer targets should be determined by supervisors on a case-by-case basis. At the same time it is very important that the basis for the case-by-case decision is harmonised across the EU to allow for level-playing field.

***Question 43**: What is the most suitable macro variable (or group of variables) that may be used in the counter-cyclical buffer to measure the dynamics of macro-level risks pertinent to the banking sector activities?*

We are of the opinion that it would be difficult to decide on any specific variable or group of variables. The supervisory authorities should have the possibility to use different macro variables depending on the circumstances. Having said this, it seems like the Commission proposal is targeted towards situations where there is a strong lending growth, and that the main focus of the counter-cyclical buffer is to have a tool that could be used when leverage is growing fast in a particular market or segment. If such a tool is introduced, it is probably good to limit the use of it to situations with high lending growth, and not use it for other macro-economic purposes. In any case, it should not be a mechanical macro-model and it needs to have a built-in flexibility.

Still, it is apparent that this is a difficult tool to use, that is different from other supervisory tools since it seems more like a tool for impacting business cycles rather than managing banking risks. It is also hard to see why the tool should be used towards all banks in a market where lending is growing fast, rather than using it for impacting those banks that actually cause the high lending growth.

***Question 44**: What are the relative merits and drawbacks of capital buffers versus through-the-cycle provisioning for expected losses with respect to minimising procyclical effects of current EU banking regulation?*

Even though we generally think it is preferable to deal with cyclicality in pillar 2 capital buffers, rather than use accounting mechanisms, we think that the IRB expected loss approach is the least harmful of the proposals for dealing with cyclicality. The arguments for this is developed in the introduction of this section.

***Question 45**: Do you consider that it would be too early to fully assess the cyclicality of the minimum capital requirement?*

This is certainly the case. Basel II was not sufficiently implemented in the present crisis in order to make it possible to draw conclusions on cyclicality. Also, too few proper analyses have been made on data from the crisis.

Systemically important financial institutions

We would like to stress the importance of maintaining the level playing field between different institutions independent on whether they are of different size or deemed to fall within a category that is considered as of high systemic relevance. In our view, larger institutions are already subject to more supervision with higher demands from the supervisory authorities. Hence, we cannot see the need of special regulation for institutions defined as systemically important. Furthermore, we see the obvious problem to find a robust definition of these systemically important financial institutions.

We do however agree with the Commission that systemic importance is driven by a number of factors such as interconnectedness and financial infrastructure. These issues should primarily be managed by improving infrastructure, which is being proposed with the suggestions on CCP, and not by adding more requirements on large banks. The establishment of the European Systemic Risk Board would, in our opinion, be one proper way to ensure the treatment of systemic importance across financial sectors and markets.

Single rule book

We support the Commission's objective to create a single rule book and thereby strengthening the level-playing field. We also agree with the Commission that a single rule book at the same time must encompass the necessary differentiation according to national and product circumstances. We believe that this is especially true when it comes to mortgage lending, since there are significant differences in the real-estate markets in the individual Member States due to historic and structural reasons.

We are of the opinion that it should be possible to treat exposures secured by mortgages with consideration taken to the local differences. As indicated by the surveys done by the CEBS[1] and the Commission[2], the rates of value fluctuation are very different in the different Member States. Despite all harmonisation efforts in this field, it needs to be accepted that the residential real estate markets are not homogeneous and therefore it should be up to the local competent authority to decide on the maximum LTV for preferential treatment of residential real estate lending.

The gain of a hard test on residential property would, in our view, be very limited since residential purchases to a very large extent is long term commitment to home ownership (owner-occupied) and not made on a speculative basis. Therefore the risk of the borrower does not depend on the performance of the underlying property. Furthermore, introducing a hard test would mean a large cost for the banks and for the supervisors when they are forced to set up systems to collect the necessary data.

We also oppose to use a Loan To Income (LTI) ratio as a precondition for preferential treatment of residential real estate lending. LTI are already used in different ways in different banks and countries when granting loans, and it is an important aspect when looking at the individual customer. But to be able to harmonise the LTI as a regulatory standard seems to us impossible. The reason for this is that the income, social welfare, tax, macroeconomic factors etc. differs significantly from country to country. Therefore a possible introduction of a harmonised ratio would have very different impact in different countries which would hinder a level-playing-field.

Finally, we cannot support the Commission proposal to introduce measures to address real estate lending throughout the economic cycle. It is our opinion that the proposals in the section on countercyclical measures of the working document covers this. To introduce further provisions for mortgage lending would therefore be redundant and difficult to implement. Considering the differences mentioned above between the national real estate markets we believe that it would be wrong to introduce a general measure to address pro-cyclicality in mortgage lending.

SWEDISH BANKERS´ ASSOCIATION

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[1] CEBS's second advice on options and national discretions
[2] ECFIN Retail Banking Survey