Realkreditrådet
ASSOCIATION OF
DANISH MORTGAGE BANKS

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
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Consultation response:
Basel committee: Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability

The Association of Danish Mortgage Banks would like to thank the Basel Committee for the opportunity to comment on the Committee's proposal for new requirements in relation to the loss absorbency of regulatory capital. We fully support the Basel Committee's aim to ensure that losses are borne by investors before any public funds are injected into banks in distress.

We have noted that in its consultative document "Strengthening the resilience of the banking sector", the Basel Committee emphasised that the regime should accommodate the specific needs of non-joint stock companies, such as mutuals and cooperatives, which are unable to issue common stock (point 68). This is of major importance to Danish specialised mortgage banks, which are often organised as non-joint stock companies that are unable to issue new share capital, certificates or any other type of common equity capital. Maintaining a level playing field between different types of corporate and ownership structures is essential to us – not least in view of the much stricter common equity requirements announced by the Basel Committee in September.

In Denmark, the general rule is that supplementary capital and hybrid capital are loss absorbing, also on a going concern basis in the case of banks that are close to distress. Typically share capital, hybrid capital and supplementary capital are retained in the original company, while remaining assets and liabilities are transferred to a subsidiary set up for that purpose. The subsidiary is then gradually liquidated or sold.

We propose that the Basel Committee's new capital framework provide for a similar loss absorbency regime rather than just focusing on the terms of the individual capital instruments.

Motivation:
It is important that the new capital framework is not restrictive in relation to national solutions. There may be different solutions to the same problem depending on conventions and business and market structures.

We propose the following improvements to the Basel Committee's proposal:

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Proposal:
We propose allowing a principal revaluation of Tier 1 and Tier 2 instruments after recapitalisation of a credit institution.

Motivation:
We do not believe that the current proposal supports a level playing field between non-joint stock companies and other ownership structures. The reason is the proposal's requirement for a permanent principal write-down or conversion into shares at the point of non-viability. A permanent principal write-down without any possibility of subsequent revaluation will disadvantage investors in capital instruments subject to principal write-down compared with investors in capital instruments that are convertible into shares.

It will therefore be significantly more expensive to issue capital instruments subject to permanent principal write-down, not least because (non-viability) triggers are unpredictable, and investors will demand considerably higher interest rates to accept them. Consequently, non-joint stock companies are strongly disadvantaged compared with joint stock companies.

It should be noted that it is not enough to recognise the certificates etc issued by some non-joint stock companies in certain jurisdictions. Other non-joint stock companies do not have the same possibility of issuing instruments that qualify as common equity.

It is therefore essential to the future level playing field between non-joint stock companies and joint stock companies that non-joint stock companies be authorised to issue Tier 1 and Tier 2 instruments on equivalent terms of competition (instruments with a revaluation option) so that non-joint stock companies are not "penalised" through capital requirements for their choice of business model – a business model which generally benefits financial stability.

Proposal:
If the above revaluation option is not introduced, we propose introducing the possibility of an extra trigger in relation to capital instruments, in addition to the non-viability trigger. The purpose of the extra trigger would be to ensure write-down of the capital instrument principal at an earlier point than the point of non-viability. Also, the extra trigger should provide for a principal revaluation if the issuer remains viable after all (and does not pass the point of non-viability).

Motivation:
This would make capital instruments fully loss absorbent and just as attractive to investors as capital instruments that are convertible into shares.

Proposal:
We propose that the definition of non-viability be specified in more detail to make it absolutely clear which criteria are used (in terms of eg capital, liquidity, time frame, etc).

Motivation:
It is important to investors (and consequently to the pricing of capital issues) that the terms of capital issues clearly specify when a trigger event occurs (especially in relation to the supervisory authority's determination of non-viability). Otherwise, the issuer will end up paying for investors' concerns about policy risks in the individual jurisdictions.

Proposal:
We propose that it be specified whether the proposal covers all credit institutions, only cross-border credit institutions or only systemically important credit institutions.

Motivation:
The proposal uses all three definitions, and it is therefore unclear which credit institutions the rules are expected cover.

Kind regards

Jan Knøsgaard
Deputy Director General