Realkreditrådet
ASSOCIATION OF
DANISH MORTGAGE BANKS

REALKREDIT FORENINGEN

20 September 2013

To: The Secretariat of the
Basel Committee on Banking Supervision

by e-mail : baselcommittee@bis.org.

Response on the revised Basel III leverage ratio framework and disclosure requirements

The Association of Danish Mortgage Banks (Realkreditrådet) and The Danish Mortgage Banks' Federation (Realkreditforeningen) appreciates the opportunity to comment on the revisions to the Basel III leverage ratio framework. We support the efforts of the Basel Committee in strengthening the resilience of financial institutions.

We must, however, restate our very serious concerns regarding the introduction of a non risk-based leverage ratio as a Pillar I requirement. The more strict such a requirement is, the more likely it is to become binding for the financial institution instead of the risk-adjusted solvency level, thus defeating the purpose of calculating the latter. In the consultation paper, the leverage ratio is being made more difficult to calculate and more rigid. It is also being tightened, e.g. in the treatment of securities financing transactions and derivatives.

Instead, the leverage ratio could be an easily calculated indicator supplementing the risk-based capital requirement.

We also addressed similar concerns in our response to the Basel Committees proposal for International framework for liquidity risk measurement, standards and monitoring issued in December 2009. Our comments also apply to the revision of the Basel III leverage Ratio framework.

Subsequently we would like to present the characteristics of the Danish mortgage model and elaborate on the problems in introducing a "one size fits all" non-risk based backstop Pillar I requirement in a Danish mortgage model context.

Characteristics of the Danish mortgage model

Danish specialized mortgage banks operate subject to a specialist banking principle confining the activity of mortgage banks to mortgage lending based on mortgage bond funding. Under the principle mortgage banks are prohibited from collecting deposits. This principle is instituted in Danish legislation because mortgage bond funding is generally considered the most stable.

Mortgage loans remain on the balance sheet of the issuing mortgage bank until maturity. The mortgage bank thus carries the risk on loans until they mature. The mortgage bank

thus has strong incentives to closely monitor the credit quality of its portfolio. In case of a loan defaulting, the mortgage bank will claim the underlying collateral (the real property). Danish law ensures a fast foreclosure process implying that the mortgage bank can easily access the collateral. Further, the borrower is subject to so-called full recourse liability which means that the mortgage bank can maintain a claim on the borrower, in case the realization of the collateral results in a loss for the mortgage bank.

The system has worked for 200 years, and loan losses have been less than 1% of total lending by Danish specialized mortgage banks, including commercial lending, even during the worst crisis in the 1930s. During the recent financial crisis – following considerable declines in property prices and GDP – the loan loss level, including commercial lending, has been modest at 0.2% annualized.

Leverage ratio

Specialized mortgage banks with low credit risk and low financial risk on lending and funding are most likely to be affected under a system with a fixed leverage ratio. A "one-size-fits-all" fixed leverage ratio does not take into account tightly regulated lending limits, low credit risk as a result of solid security in the form of mortgages on real property and low financial risk due to a pass-through balance principle.

A fixed leverage ratio would either render specialized mortgage banks uncompetitive because of very high capital costs relative to competitors – or would encourage specialized mortgage banks to assume significantly increased risk.

Consequently the leverage ratio should not be rigidly applied as an extra capital requirement, but may be a useful tool in the assessment of a financial institution along with the risk-adjusted solvency level.

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Thank you for soliciting our comments as part of your Consultation. We remain at your disposal for any questions or requests for additional information regarding any of the comments set out in our response.

Best regards,

Realkreditforeningen

Karsten Beltoft

Director General

Realkreditrådet

Jan Knøsgaard

Deputy Director General