MINISTRY OF INDUSTRY, BUSINESS AND FINANCIAL AFFAIRS

Basel Committee
Centralbahnplatz 2
4051 Basel
Switzerland

MINISTER FOR INDUSTRY, BUSINESS AND FINANCIAL AFFAIRS

Dear chairman Stefan Ingves

The Danish government appreciates the opportunity to comment on the revisions to the minimum capital requirements for market risk.

Denmark strongly supports the key elements of a more coherent and risk sensitive framework for market risk. Revising elements of the standardised and internal model approach will ensure that the final outcome is in line with this intention. It is therefore also important that such a framework is properly calibrated to reflect the actual risk, such that positions with low risk also have correspondingly low risk weights and positions with high risk have correspondingly high risk weights.

We find that the revisions address most of the identified problems in this regard. However, in our view there are elements which need further revision.

First of all, in order to ensure the credibility of a new risk sensitive framework, it is important to lower the risk weight for credit spread risk for covered bonds. High quality covered bonds (rated AAA) are assigned a risk weight for credit spread risk of 400 bps which is significantly higher than historical observations, also during times of crisis. This is not in line with a risk sensitive framework, where positions with low risk should be assigned a corresponding low risk weight. Further documentation of the empirical observations for such covered bonds can found in the appendix.

Secondly, we find that the treatment of Danish Kroner (DKK) does not reflect the historical risk as it does not take fixed exchange-rate regimes into account. The DKK is part of ERM II and is pegged to the EUR within a band of +/- 2,25%. Historically, the EUR/DKK has been kept at a narrower band of +/- 0,5%. We therefore find that the risk weight for EUR/DKK should reflect this.

As a more general comment, we note that the Committee takes due considerations of the need for proportionality and we support the Committee's decision to retain the simplified alternative.

MINISTRY OF INDUSTRY, BUSINESS AND FINANCIAL AFFAIRS

Slotsholmsgade 10-12
1216 Copenhagen K
Denmark

Tlf. +45 33 92 33 50
Fax. +45 33 12 37 78
CVR-nr. 10092485
EAN nr. 5798000026001

The simplified alternative is a simple but more conservative approach well suited for institutions with smaller trading books that find the new market risk standard complex and operationally challenging. The revisions to the standardised approach as regards the risk weights and the measure of risk factor level losses, and their aggregation, will help ensure that the approach is commensurate with the actual risk making the approach a credible fall back for the internal model approach.

As always, we stand ready to answer any questions you may have.

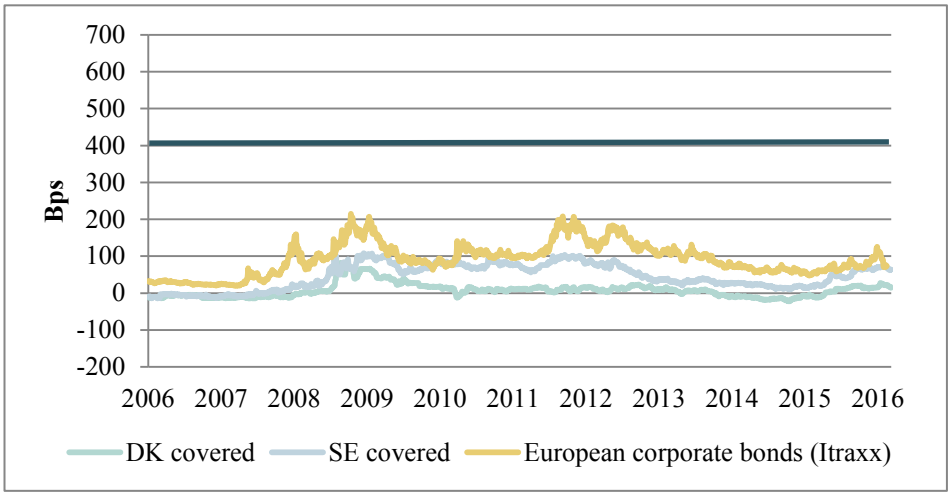
Yours sincerely,

Brian Mikkelsen

APPENDIX

High quality covered bonds (rated AAA) are assigned a risk weight for credit spread risk of 400 bps which is significantly higher than historical observations, also during times of crisis. As illustrated below in Figure 1, for high quality Danish covered bonds the largest observed credit spreads have been significantly below the risk weight and at no point in time above 100 bps.[1]

Figure 1: Swap spreads for benchmark 5-year covered bonds and corporate bonds



Source: Market data

Consequently, implementing the risk weight of 400 bps would imply a risk weight for high quality bonds that is more than 4 times higher than the largest daily observed historical spread for such covered bonds. Furthermore, the risk weight are set inconsistently high compared to the risk weights on for example financials and non-financials, which have risk weights that seem better aligned with historically observed spreads. This can be seen in the table below showing the largest credit spread movements[2], where the risk weights for covered bonds corresponds to a factor

[1] A 10-year period has been chosen to show the effects of a significant stress-period. Expanding the period by more years does not lead to other conclusions.
[2] Aligned to the corresponding liquidity horizon for the relevant instruments

that is at minimum 6 times larger than historical 20-day credit spread movements.

Risk Bucket	**Index**	**Largest historical credit spread movement**	**FRTB Risk weight (CSR)**
Financials	JP Morgan US Financials (Spread to Libor)	490 bps	500 bps
Non-financials	JP Morgan US Non-Financials (Spread to Libor)	293 bps	150-300 bp (average=238 bps)
Covered Bonds, Issued by credit institutions in Member States	Danish, Floaters	32 bps	400 bps
	Danish, Capped floaters	48 bps	400 bps
	Danish, Non-callables	59 bps	400 bps
	Danish, Callables	67 bps	400 bps
	Swedish, 2Y	67 bps	400 bps
	Swedish, 5Y	49 bps	400 bps
	Bloomberg Covered Bonds index	60 bps	400 bps
	JP Morgan Pfandbriefe Index (asset swap spread)	40 bps	400 bps
Source: Bloomberg and Danske Bank. All time series are from January 2008 (or earlier) to April 2016, expect the Bloomberg Covered Bonds Index which is from May 2010 to April 2016.			

The consequence of this is that high quality covered bonds are effectively assigned the same risk weight as lower rated covered bonds. This is not in line with a risk sensitive framework, where positions with low risk should be assigned a corresponding low risk weight.