



FINANSTILSYNET
THE FINANCIAL SUPERVISORY
AUTHORITY OF NORWAY



NORGES BANK

Basel Committee on Banking Supervision

OUR REFERENCE

YOUR REFERENCE

DATE
08.03.2016

**BCBS SECOND CONSULTATIVE DOCUMENT: REVISIONS TO THE STANDARDISED
APPROACH FOR CREDIT RISK - JOINT COMMENTS FROM FINANSTILSYNET AND
NORGES BANK**

Dear Sir/Madam,

Finanstilsynet and Norges Bank welcome the opportunity to express our views on the 10 December 2015 second consultation on revisions to the standardised approach for credit risk.

We are generally supportive of the proposal to make the standardised approach more risk-sensitive and the risk weights less mechanistically dependent on external credit ratings. It is important that the standardised approach reflects to a reasonable extent the riskiness of exposures, in order to provide sound incentives for the banks employing this approach in their lending policies. At the same time, we believe that a risk-weighted system should have a backstop, as is being developed by the Basel Committee (leverage ratio and effective floors on risk weighted assets for IRB-banks). The revised standardised approach may also represent a better and more realistic alternative for banks that would otherwise consider applying for IRB approval. While we agree that the standardised approach should neither rely on internal-modelled approaches nor mechanistically rely on external ratings to set capital charges, the inclusion of specific measurable metrics for the assessment of credit risk and related capital charges should serve to support improved objectivity and comparability across jurisdictions. Additionally, consideration should be given during final calibration of this proposal to ensure that updated standards do not result in an undue overall reduction in capital levels for banks employing this approach.

FINANSTILSYNET
Revierstredet 3
P.O. Box 1187 Sentrum
NO-0107 Oslo

Tel. +47 22 93 98 00
Fax +47 22 63 02 26

post@finansstilsynet.no
www.finanstilsynet.no

Norges Bank
Tel. 22 31 60 00
Faks 22 41 31 05
www.norges-bank.no
central.bank@norges-bank.no



Specific comments on the proposal are noted below:

Exposures to banks

Finanstilsynet and Norges Bank view the proposal for risk weighting of exposures to banks as appropriate for the general treatment. However, we believe that covered bonds should not be treated on par with other exposures to banks. Covered bonds are less risky as they have a preferential claim over the institution's cover pool and should therefore benefit from a preferential treatment.

Exposures to corporates

Proposal to apply a lower risk weight for exposures to SMEs

Finanstilsynet and Norges Bank do not agree with the proposal to apply a lower risk weight for exposures to SMEs relative to that for other corporate exposures; as such a reduction will not appropriately reflect the inherent risk of these different exposure types. This position is based upon an analysis that we have undertaken of nearly every Norwegian company exclusive of financial sector entities and oil companies, for the period 1988-2014. During the period, debt-weighted PDs for SMEs on average have been significantly higher than those for large enterprises, cf. Figure 1, Attachment. The difference in PD levels was particularly great in the years surrounding the banking crisis (1987-1992), when credit risk in Norway was at a relatively high level. We have also analysed the proportion of companies with negative equity within each corporate group. Our findings have indicated that it is far more common for SMEs to have negative equity than it is for large companies, cf. Figure 2, Attachment. Negative equity could often lead to higher levels of loss given default due to increased probability of borrower bankruptcy.

The consultation paper states that a lower risk weight for SMEs may be justified due to the presumption that SMEs provide more unrecognised collateral than other large corporates. If such other collateral is actually of value during an economic downturn, it should be defined, measured and included within eligible collateral. It is not prudent to provide a lower risk weight based on a general assumption that SMEs may have provided unrecognised collateral that could considerably reduce losses.

The consultation paper also indicates that a lower risk weight for SMEs may be justified due to lower asset correlation, i.e. lower systematic risk. However, if a greater share of the risk factors of SMEs is due to idiosyncratic risk, such risk across borrowers can only be reduced in properly diversified portfolios. For the retail exposure class, a granular criterion is set to ensure diversification, but such a diversification requirement is not proposed for the corporates exposure class. We see no reason why a lower risk weight should be applied for SMEs when such preferential treatment is not accompanied by sufficient diversification requirements.

Investment Grade Criteria

Regarding the proposal for a lower risk weight for "investment grade" corporate exposures in

jurisdictions that do not allow the use of external ratings for regulatory purposes, we believe the definition of "investment grade" is too loosely defined. To meet the definition of "investment grade" specific criteria should be fulfilled, in order to ensure that proposed standards support consistency and objectivity. Without such metrics, the determination of "investment grade" would be highly subjective, potentially challenging the comparability of credit-related capital charges across jurisdictions.

Exposures secured by commercial real estate

We believe that commercial real estate collateral should not be recognized as qualification for a significantly lower risk weight, since steep declines in market prices of such collateral may be a major driver of bank losses during a banking crisis. In addition, commercial property can be highly specialised and notably sensitive to business cycles, potentially resulting in very limited collateral value in the case of borrower bankruptcy. During the Norwegian banking crisis (1987-1992) the increase in banking sector losses related to commercial real estate was significantly higher relative to total portfolios, cf. Figure 3, Attachment. These experiences highlight the heightened risk associated with commercial real estate lending as well as the need for appropriate risk weightings for such banking activities.

Yours sincerely,



Erik Lind Iversen
Acting Deputy Director General
Finanstilsynet

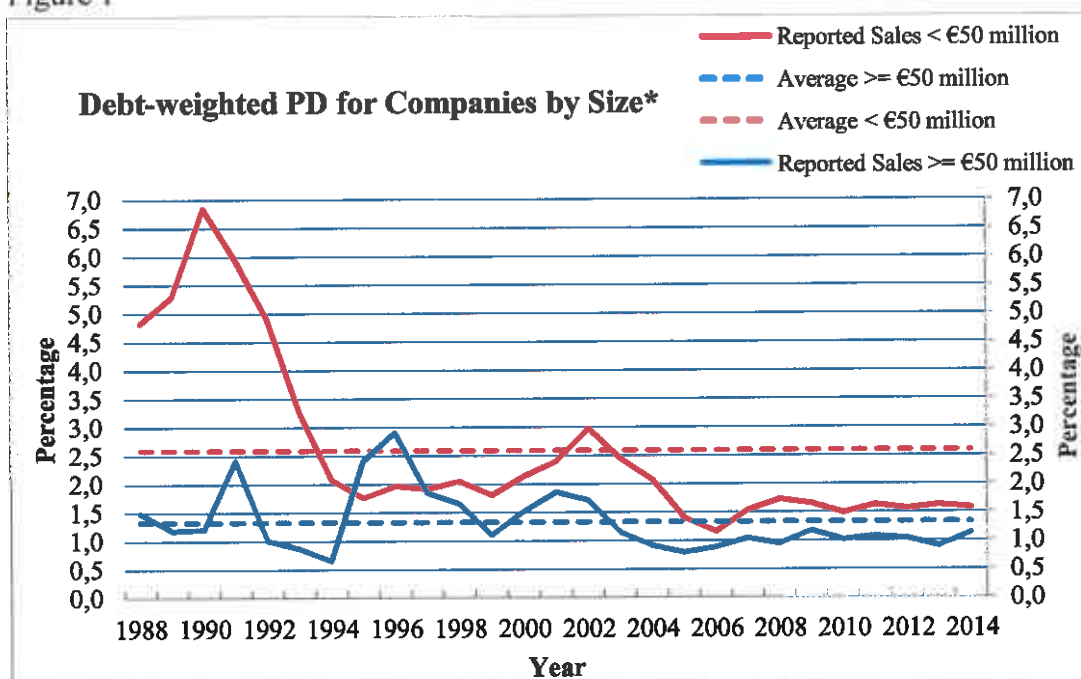


Sindre Weme
Acting Executive Director
Norges Bank Financial Stability



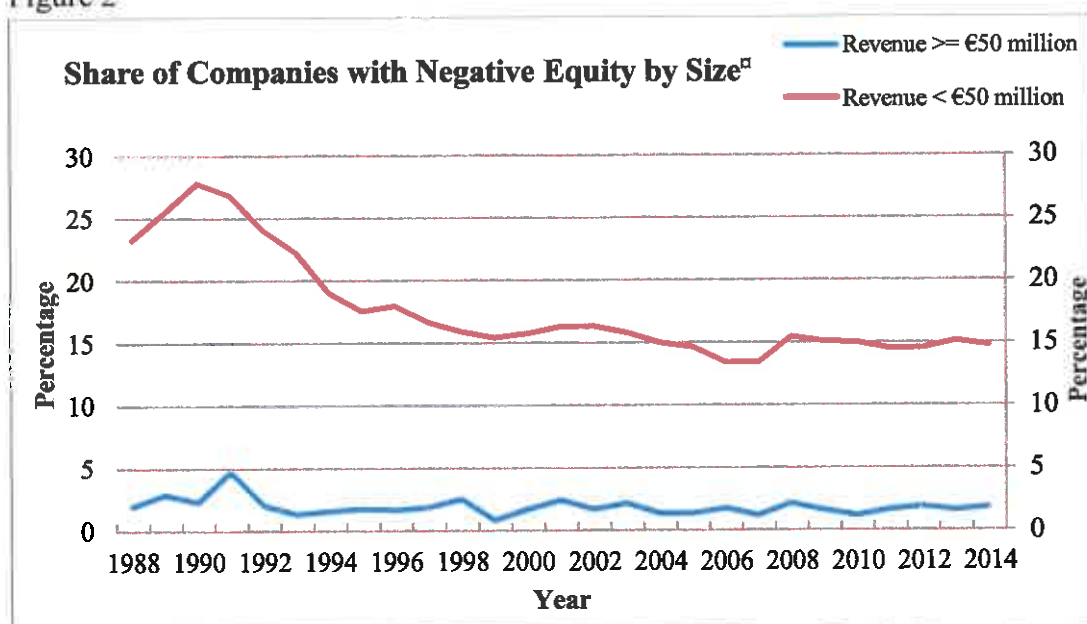
ATTACHMENT

Figure 1



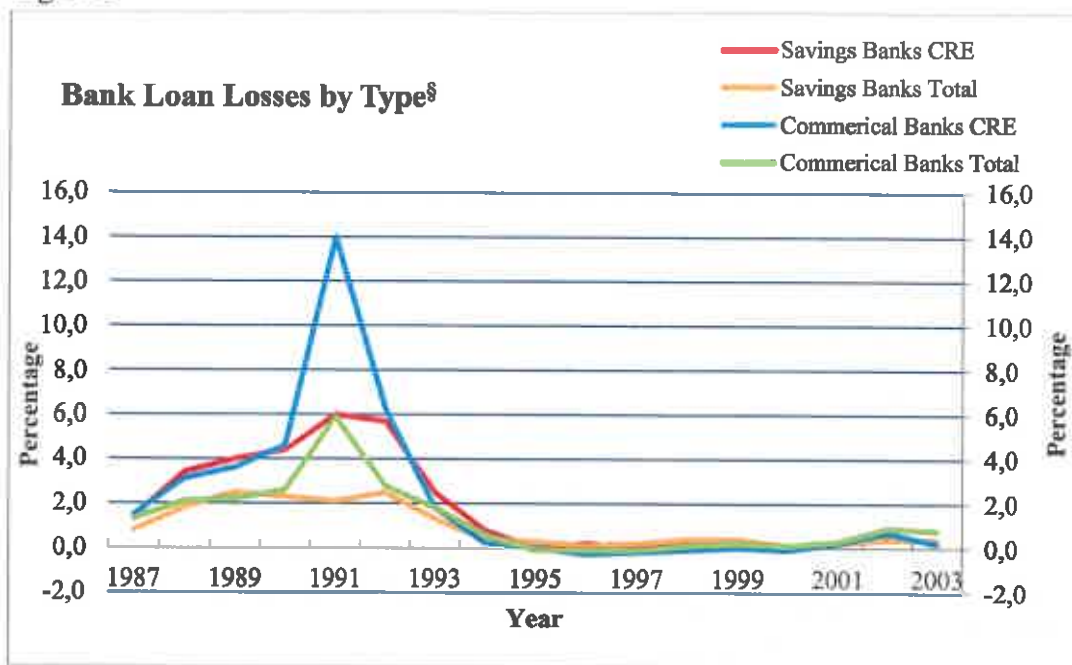
* Source: Sebra. Debt-weighted PD of companies analysed by size, consisting of all industries in Norway excluding financial sector and oil companies.

Figure 2



[□] Source: Sebra. Percentage share of companies analysed by size, consisting of all industries in Norway excluding financial sector and oil companies.

Figure 3



[§] Source: Norges Bank and Finanstilsynet. Norwegian loan losses as a percent of lending by bank type (savings or commercial) and loan type (commercial real estate (CRE) or total portfolio).