



Basel Committee on Banking Supervision
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Finance Norway's response to the BCBS consultation on the design of a revised capital floor framework

Finance Norway welcomes the opportunity to express the views of the Norwegian banking industry on the Basel Committee's consultation on the design of a capital floor framework based on standardized approaches.

Finance Norway would firstly emphasise that it is of fundamental importance that the same basic methodologies are applied for the calculation of key requirements, such as the capital ratio. As the Basel Committee points out, differing implementations of the Basel I floor have generated RWA inconsistencies and excessive dispersion, thereby impairing the comparability of IRB banks' capital ratios. It is therefore imperative that a revised floor is identically implemented across jurisdictions.

Even within Europe, the Basel I floor is currently generating RWA inconsistencies. For instance, Norway applies the Basel I floor as a backstop/floor on risk-weighted assets (RWA), while to our knowledge, the floor is applied as a lower threshold on own funds in EU member states.¹ Hence, the EU version of the floor has no effects on banks with capital adequacy higher than 80 percent of the minimum under Basel I, and is accordingly not a backstop on RWA. For two identical banks with the same risk profile, one located in an EU member state and one located in Norway, the capital ratio of the Norwegian bank would generally be lower than its European peer. The misalignment influences the rating and funding costs of the banks, and the relative competitiveness when the two banks operate in the same market.

In order to achieve a level playing field, it is crucial to apply a harmonized risk measurement as a basis for harmonized capital requirements. The latter cannot be attained unless the first is in place. The only way to obtain a level playing field is through ensuring a uniform implementation of a revised floor. This implies absence of national discretion as regards the methodology for imposing the floor.

¹ More specifically, according to CRR Article 500, own funds cannot be lower than 80 percent of the minimum under Basel I, which can be reformulated as the requirement that the capital adequacy ratio cannot be less than 6.4 percent as measured under Basel I ($0.8 \times 0.08 = 0.064$).

Moreover, the floor must be designed to be consistent with the rest of the Basel III framework. The framework already contains a backstop on capital through the leverage ratio. The introduction of a revised Basel floor as a backstop on capital is therefore superfluous. The only reason to maintain a floor in a framework in which a floor on capital already exists, is to curb undesirable RWA dispersion and restore confidence in the IRB approach. A prospective floor should consequently be explicitly defined as a RWA backstop, to harmonize RWA for similar risk across IRB banks and jurisdictions.

Furthermore, Finance Norway prefers a granular RWA floor instead of an aggregate RWA floor. Norwegian IRB banks have years of experience with a floor on total RWA. An aggregate RWA-based floor has unfortunate effects, as it typically creates complex marginal capital effects that are difficult to handle. For the one and the same bank, an aggregate floor could either be binding or not binding for different exposures, and typically causes offsetting effects. Offsetting effects give rise to implicit (or effective) risk weights on exposures in which the floor is binding, and the implicit weights depend on the risk-weighted exposures in which the floor is not binding.²

Levels of implicit risk weights are in other words a function of the overall balance sheet structure and risk weights on “non-binding” exposures. Implicit risk weights are highly opaque, and have a significant negative bearing on good risk management practices. In this respect, a granular system of floors, i.e. by risk category and also by exposure class for credit risk, based on a revised and more risk-sensitive standardised approach, is preferred (cf. Q1). Still, it is of essential importance that a granular floor system is appropriately calibrated to preserve material incentives for developing and using internal models.

In conclusion, Finance Norway recommends a granular and transparent risk-based floor system that is carefully calibrated, and which is explicitly defined as a backstop on RWA (not own funds). We appreciate your consideration of the points raised in this letter.

Yours sincerely

Finance Norway



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² Implicit risk weights can be defined as those that would leave total RWA unaffected if the floor is removed.