



Basel Committee on Banking Supervision
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Finance Norway's response to the second BCBS consultation on Revisions to the Standardised Approach for credit risk

On behalf of the Norwegian financial industry, Finance Norway welcomes the opportunity to comment on the second consultative document put forward by the BCBS on revisions to the Standardised Approach for credit risk. From our point of view, concurrent consultations for revisions to the SA, the IRB Approach and the capital floor would have been preferable since this would facilitate an informed consultation on the prospective regulatory framework. Still, we appreciate several of the new proposals in this second consultation, and value the Committee's efforts to strike an appropriate balance between comparability, risk sensitivity and simplicity.

In particular, Finance Norway welcomes the reintroduction of external ratings for regulatory purposes, the emphasis on risk sensitivity and the maintained proposal of a common standard across jurisdictions. We assess the absence of a scope for national calibration of SA risk weights as a proper preference for simplicity, and deem it as a precondition for cross-border comparability and a level playing field. Moreover, and particularly concerning corporate exposures, Finance Norway views enhanced risk sensitivity beyond the Committee's proposal as important and warranted.

Comments by asset class

Bank exposures

The option to determine risk weights on the basis of sovereign risk is abolished in this proposal. As a consequence, unrated banks in jurisdictions with low sovereign risk would be unduly penalised with a substantial increase in risk weights.

The banking sector in Norway is characterised by a relatively high number of banks; a few large commercial banks, some medium sized banks and several small unrated savings banks. In Norway the latter group of banks have the highest capital ratios. For these banks, funding costs are expected to rise significantly due to the risk weight leap, without this reflecting actual credit risk. This may undermine the Norwegian savings bank model which has been imperative for the supply of financial services throughout the country. Moreover, incentives to issue covered bonds will increase.

Against this background, we ask the Committee to make the Standardised Credit Risk Assessment Approach (SCRA) more granular, by e.g. introducing a new grade bucket (“A+”) with a 20% risk weight for banks with a very strong capital and liquidity position.

Given that the risk profile of covered bonds generally differs from that of the issuing bank, separate and preferential risk weights should be assigned to covered bonds, reflecting the historically low level of losses in the covered bond market.

Corporate exposures

We welcome the recognition of external ratings for corporate exposures. The rating coverage of non-financial firms is, however, quite limited and mostly confined to large companies. In fact, a significant share of banks’ corporate exposures comprises mid-cap companies without external rating, and such exposures will obtain a risk weight of 100%. For such a significant exposure class, Finance Norway considers the proposal as overly simple, and we therefore recommend the Committee to develop a simplistic risk based approach for exposures to unrated companies under the External Credit Risk Assessment Approach, ECRA.

Furthermore, in the Standardised Credit Risk Assessment Approach (SCRA), exposures to mid-cap companies will attain a risk weight of 75% if the companies qualify as “investment grade”. In our view, this implies an unjustified diverging approach between the ECRA and SCRA for unrated companies classified as “investment grade”. If the latter exposures were assigned a 75% risk weight under the ECRA, the two approaches would be aligned and a certain degree of risk sensitivity would be safeguarded.

Moreover, we consider that increased risk sensitivity, beyond the Committee’s proposal, is reasonable also for rated corporate exposures. The risk weights for corporates with an external rating from BBB+ to BBB- is too high compared to the inherent risk. In the Norwegian market, history on default and loss given default for corporates with ratings from BBB+ to BBB- does not warrant risk weights of 100%.

We welcome the lower risk weight for exposures to SMEs, as these exposures have low correlation and often more unrecognised collateral than larger corporates. There should be

no national discretion to set the risk weight higher for SMEs, as this will reduce comparability.

Mortgages

We strongly advise that the LTV ratio for residential real estate exposures should be calculated using updated property valuations in jurisdictions where such value updates are available. Keeping the property value constant, as it is proposed in this consultation, has several shortcomings:

- Risk sensitivity will be reduced, contradicting the objective of the revisions. The LTV is a key risk variable, and an outdated LTV gives an incorrect measure of risk.
- Competition in the mortgage market could be weakened. Falling house prices will cause a lock-in effect of borrowers since switching of banks results in a higher LTV, capital requirement and lending rate (*ceteris paribus*). In a market with rising house prices, the opposite effect will occur. If the customer switches bank, the capital requirement related to the mortgage will fall. The customer will thus have an incentive to refinance or switch bank.
- Moreover, this type of regulation will increase operational costs. Risk depends on concurrent collateral values and risk calculations should thus be based on updated property values. Operating with two sets of property valuations, one updated for management purposes and one outdated for regulatory purposes, is unnecessary.

Finance Norway prefers the option of loan splitting (versus “whole exposure”) in the allocation of exposure at default to loan-to-value (LTV) buckets. An undesirable incentive to split the loan between different entities arises if the loan splitting option is not recognized. Furthermore, loan splitting avoids cliff effects as marginal increases in LTV would lead to disproportionate increases in risk weights. The loan splitting also better reflects the risk associated with junior liens as the risk weight of higher LTV bands increases accordingly.

Finance Norway believes that more granularity is warranted for lower LTV levels (below 40%), in line with the exposures’ underlying risk.

Lastly, we have some concerns with regard to the treatment of exposures to housing cooperatives. The legal characteristics of such exposures differ from mortgages but the inherent risk is the same - the repayment depends on the cooperative’s members’ debt-servicing capacity. Exposures to housing cooperatives should therefore be considered as a residential real estate where repayment is not materially dependent on cash flows generated by the property.

Off balance sheet commitments

We are concerned that commitments to corporates are given the same risk weight regardless of the commitment being unconditionally or conditionally cancellable. This

approach does not acknowledge the inherently different nature of these two types of commitments.

The proposal to assign a 100% risk weight to unsettled securities transactions might have a significant impact and should be further assessed as a part of the QIS.

Yours sincerely
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