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Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel

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# COMMENTS TO THE CONSULTATION ON REVISONS TO THE STANDARDISED APROACH FOR CREDIT RISK

Dear Sirs,

Reference is made to the consultative document on revisions to the standardized approach for credit risk 22 December 2014. Please find below a brief description of Kommunalbanken and some comments to the proposals in the document.

## 1. About Kommunalbanken (KBN)

KBN is a central government owned funding agency for the local government sector in Norway. The Norwegian local government sector responsibilities include primary and secondary education, infrastructure and transport, primary health care, housing, social services and public utilities. The sector accounts for approximately 20 % of mainland revenues and employment. KBN has assets of approx. EUR 55 bn, and a market share of approximately 50 % of lending to the Norwegian local governments.

KBN is an authorised credit institution, supervised by the Financial Supervisory Authority of Norway, and is subject to the Basel standards through the implementation in Norway of EU prudential requirements. KBN does not hold a banking license, however, and is therefore not allowed to take deposits. KBN is solely funded through the capital markets. The Norwegian Ministry of Finance has designated KBN as a domestic systemically important financial institution in Norway, and KBN is consequently also subject to prudential and supervisory requirements applied to such institutions.

### *1.1 Ownership and mandate*

KBN is 100 % owned by the Norwegian central government and organised as a limited liability company. The Articles of Association limits KBN to lend only to Norwegian local governments or entities that carry an explicit guarantee from a Norwegian local government, and limits the ownership of KBN to Norwegian central or local government. The Articles of Association can only be changed by decision of the central government.

KBN has a public policy mandate from the central government to provide low cost finance to the Norwegian local government sector. In addition, the central government, as the sole owner, expects KBN to deliver a competitive return on invested capital. KBN does not, however, operate under an objective of profit maximization.

## 2. Comments to the consultative document

In paragraph 12 of annex 1, a definition of bank exposures is introduced, encompassing claims (including loans to, and senior debt instruments of, banks) on any financial institution that is licensed to take deposits from the public, and is subject to the prudential standards and level of supervision in accordance with the international practices relevant for such an institution.

Though not a deposit taking institution, we note that it is proposed that exposures to other financial institutions should be treated as exposures to banks provided that these firms are subject to equivalent prudential standards and supervision, and presume the rules for bank exposures would be relevant for KBN, also after the proposed revision.

BCBS proposes that bank exposures should be risk-weighted based on risk drivers, instead of on the basis of the external credit rating of the bank or of its sovereign of incorporation, as under the present approach. Under the proposal for exposures to banks, risk weights will be assigned based on a look-up table where a capital adequacy ratio and an asset quality ratio are cross-referenced to give a risk weight range from 30 % to 300 %. ). According to the consultative document, the table is designed to reflect the expectation that a bank with higher capital adequacy and asset quality ratios will have a lower risk of default, and therefore should receive a lower risk weight.

Whilst selecting risk drivers with good predictive power as regards bank insolvency seems to be a relevant and reasonable general approach, we are concerned that the proposed risk weight ranges does not adequately cater for the least risky assets.

Under the existing ratings based approach, exposures to Kommunalbanken as an AAA-rated institution located in an AAA-rated jurisdiction, may be assigned a risk weight of 20 %. As noted above, all loans granted by KBN are issued to or explicitly guaranteed by the Norwegian local government sector. KBN has never in its 88 years of operations suffered a loan loss. According to the Local Government Act, Norwegian local governments cannot file for bankruptcy, and local governments are by law required to repay all debts, including principal and accrued interest. Extensive control mechanisms have been built into the institutional framework for local governments, including central state supervision of local government budgets and medium-term financial plans. It could on that basis be argued that even a risk weight of 20 % might be considered too high.

We note BCBS' statement that it is not the objective to increase overall capital requirements under the standardised approach, but rather to ensure that capital requirements should be commensurate with underlying risk. On that basis, we urge BCBS' to consider retaining a risk weight of 20 % for the least risky assets, regardless of the basis chosen for assigning risk weights.

We note that it might not be practical to impose the proposed treatment for all financial institutions, hereunder multilateral development banks. BCBS recognises that the business models, corporate governance structures and shareholder composition of MDBs are very specific, and ill-suited to the proposed risk-weight treatment for bank exposures. BCBS therefore proposes that claims on such MDBs should be treated as corporate exposures. We agree with BCBS observation that such treatment might be unduly punitive, however, and agree with the proposal of introducing a subcategory of "qualifying MDBs" that retains the current risk weights based on the MDB's external credit rating, provided that certain conditions are met.

In our view, it could furthermore be argued that government owned specialised public funding agencies, like KBN, satisfy the criteria of such MDBs, as given in Annex 1, paragraph 11 (a) (i)-(v), and therefore should at least be subject to the treatment proposed for the Qualifying MDBs.

KBN also questions why the BCBS might consider it counterintuitive that exposures to systemically important banks, subject to higher capital requirements, would receive a lower risk weight under the proposed method. To Kommunalbanken, it would seem intuitive that a bank with more loss absorbing capital ceteris paribus would face a lower risk of failure, irrespective of whether the bank held such capital for regulatory or for other reasons. Whether the risk weights for institutions facing higher capital requirements seem intuitive or counterintuitive should in any case not matter. Since BCBS bases the approach on whether risk drivers are significant predictors of bank failure, it would presumably be possible to derive probability distributions for the risk associated with institutions facing higher capital requirements, and to assign appropriate risk weights on that basis.

Yours Faithfully,

Kristine Falkgård
President & CEO, Kommunalbanken AS