

Basel Committee on Banking Supervision
Centralbahnplatz 2
4051 Basel
Switzerland

**MINISTER FOR BUSINESS AND
GROWTH**

Dear chairman Stefan Ingves

The Danish government appreciates the opportunity to comment on the second consultative document on revisions to the standardised approach for credit risk.

In the attached annex the views of the Danish government are specified in more detail. For Denmark, the key issues are as follows.

First of all, we support the Basel Committee's overall objective of enhancing risk sensitivity and comparability between institutions while at the same time maintaining simplicity. However, this overall objective is difficult to achieve in practice. In order to ensure risk sensitivity and comparability in a way that reflects the underlying risks, differences between jurisdictions must be taken into account.

By way of example, the current Basel standard approach and the consultative document does not give covered bonds a specific treatment. Thereby the legal and economic characteristics of covered bonds are not taken into account. If this implies that covered bonds are bundled with other exposures to institutions, the risk embedded in covered bonds could be overstated. In Europe, covered bonds have a specific treatment reflecting the lower risk in these exposures. This specific treatment achieves a better risk sensitivity and ensures that the risk weights reflect the underlying risk of the exposures. It is in our view of utmost importance that we can keep this specific treatment and we therefore find that the Basel Committee should take this issue into account.

Secondly, the Danish government supports the Basel Committee's view that the objective of the revised standardised approach should be to ensure that the capital requirement reflects the underlying risks and not to increase the overall capital requirements as such. In this regard, however, the calibration should not only take the global level into account. In our view, it is equally important that the calibration does not impose an unwarranted capital requirement increase for certain jurisdictions or specific low risk portfolios where such an increase is not related to the underlying risks of the exposures.

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Finally, we note that depending on the final standard, the revised standardised approach could end up as the basis for a capital floor for IRB institutions. It is in our view very important that a capital floor only serves as a back stop to risk-based requirements. Risk-based capital requirements – when properly regulated and supervised – provide appropriate incentives for credit institutions and they promote efficient capital allocation to the benefit of our economies. Such an approach could be followed by implementing the capital floor as a supplementary requirement that would only kick in if the risk-based minimum capital requirements and buffers are lower than the capital floor. This is consistent with the European implementation of the current Basel accord.

Overall, as you will understand, the Danish government has major concerns when it comes to the revised capital floors. We were therefore very pleased to see the statement in the Danish media on 18th March 2016 from Margaret Critchlow from the Basel Committee indicating that our concerns on the possible effects are “speculative and based on rumours”.

I would be very interested in a meeting with you Mr. Chairman in the nearest future in order to discuss the current work of the Basel Committee and especially the revised capital floors.

Please also find our elaborated comments in the annex. As always, we stand ready to answer any question you may have in relation to the above.

Yours sincerely,



Troels Lund Poulsen

ANNEX

18. March 2016

Danish response to the second consultative document from the Basel Committee on revisions to the standardised approach for credit risk

General remarks

As mentioned in our general comments, we find that differences between jurisdictions must be taken into account.

In this context, we generally welcome the move away from harmonised multi-dimensional risk drivers towards the reintroduction of ratings, although we recognize that this approach is not flawless either. The multi-dimensional risk drivers did not capture the differences between countries with respect to legal systems, insolvency procedures, loss experience etc. which all affect risk. Furthermore, the risk drivers implied more complexity as well as lower risk sensitivity and comparability. Allowing the use of ratings could strengthen the risk sensitivity and comparability across jurisdictions as ratings take country specific characteristics into consideration to better reflect the true underlying risks.

National discretions in certain selected areas where jurisdictions historically differ significantly will also strengthen the risk sensitivity and comparability. Therefore, we suggest that such national discretions should be allowed to a higher extent. Such national discretions could then be accompanied with clear criteria for their specific application.

As mentioned in our general comments, the current Basel standard approach and the consultative document does not grant covered bonds a specific treatment. Grouping covered bonds together with other exposures runs the risk of overstating the risk embedded in covered bonds. In Europe covered bonds have a specific treatment and it is in our view very important that we can keep this treatment in order to reflect the low risk in covered bonds. We therefore find that the Basel Committee should take this issue into consideration.

Furthermore, it is essential to avoid too much complexity and reduce the administrative burden for institutions using the standardised approach. This is important in order to preserve a competitive environment among

institutions of different sizes. The second consultative document has reduced the complexity and administrative burden considerably compared to the first consultative document. This should continue to be a high priority when finalising the risk weight calibration.

We support the Basel Committee's view that the objective of the revised standardised approach is not to increase overall capital requirements. As mentioned in our general comments, it is in our view equally important that the calibration does not impose a capital requirement increase for certain jurisdictions or specific low risk portfolios which is not justified by risk. This needs to be carefully considered going forward.

Specific remarks

We support elements in the proposal which implies a more risk sensitive approach in relation to the risk weights to real estate exposures. For instance, we support that an exposure where repayment is materially dependent on cash flows generated by the property is assigned a higher risk weight. Also for residential real estate exposures, we support that the risk weight varies dependent on the loan-to-value (LTV).

In our view, however, it is equally important that the revised standardised approach remains risk sensitive when the LTV exceeds 100% for residential real estate exposure. If the full exposure is assigned to the counterparty's risk weight, the assigned risk weight fails to take into account the low risk entailed in the secured part of the exposure. We find that this lack of risk differentiation introduces a cliff effect which furthermore goes against the objective of risk sensitivity. A more risk differentiated approach for LTV exceeding 100% should be considered. In our view, it would be more risk sensitive to take the proposal's other risk weights as the basis. In this way, if the LTV exceeds 100% the part of the exposure with LTV within 100% could be assigned a preferential risk weight of 55%, reflecting the lower risk of such an exposure, while the part of the exposure with LTV exceeding 100% could be assigned a higher risk weight reflecting the higher risk of this part of the exposure.

Furthermore, Denmark supports that the credit conversion factors (CCF) for off-balance sheet exposures currently do not sufficiently reflect the underlying risks in these exposures. In particular, from a risk perspective we agree that the CCF for the low risk category should be higher than 0%. However, a 20% CCF is in our view too conservative and may impose an unwarranted capital requirement increase. This should be carefully assessed in the impact study.

In the revised standardised approach, a 50% risk weight add-on to certain exposures with a currency mismatch is proposed. This treatment is pro-

posed where the lending currency differs from the currency of the borrower's main source of income and where the exposures are unhedged. We agree that, in general, exposures with currency mismatch are subject to a higher credit risk. However, in our view the currency mismatch should take institutional currency arrangements into account. In this regard, e.g. the ERM II fixed exchange rate system should be taken into account as the exchange rate risk is significantly reduced under this system. This is an example where a national discretion taking into account institutional arrangements is appropriate.

Final remarks

There is a link between the revised standardised approach and a potential new capital floor for IRB institutions. In case the revised capital floor is not introduced as a supplementary measure, the revised capital floors could lead to high capital requirement increases for low risk business models which are not justified by risk. It will be very important to avoid such unintended consequences when evaluating the impact study and related proposals.

In addition, we find it important that risk-based capital requirements are comparable between jurisdictions. The risk weight calibration should not result in unwarranted incentives and affect truly low risk portfolios unintendedly. In this regard, the possibility of national discretions should be maintained where such discretions take into account national specificities with regard to legal systems, insolvency procedures, loss experience etc., lead to higher risk sensitivity and comparability.