FINANSRÅDET

DANISH BANKERS ASSOCIATION

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Basel Committee on Banking Supervision
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Basel II - Consultative Paper 3

Danish Bankers Association welcomes the opportunity to comment on the third consultative document on the new capital accord. We would like to draw the following points to the attention of the Committee. For further elaboration on the issues mentioned please feel free to contact us.

1. Qualifying revolving retail exposures:

The definition of qualifying revolving retail exposures favours the market structure in countries, where revolving credits are provided through unsecured credit cards.

This is an unacceptable movement away from the purpose of a more accurate risk assessment. The decisive factor should be whether a low probability of loss can be documented and not whether the facilities are secured or unsecured. Capital requirements for secured credits should never be higher than requirements for similar unsecured credits, since collateral only increases the incentive to pay.

In Denmark revolving credits are given as a credit facility in connection with the customers wage account and collateral often covers all outstanding amounts between the customer and the bank, i.e. focus is on the customer and not the single product. The consequence of the capital accord would be a move towards unsecured revolving credits, which does not serve customers interests.

According to footnote 25 retail commitments can be considered unconditionally cancellable, if the terms permit the bank to cancel them to the full extent allowable under consumer protection and related legislation. A similar footnote would be appropriate in relation to qualifying revolving retail exposures to avoid any punishment of banks in countries with a high level of consumer protection.

2. National discretions:

The amount of national discretions is unnecessarily high. It is important to work towards a harmonized capital accord to avoid complexity especially for international banking groups and, not least, to create a level playing field for institutions that are competing on the same markets.

It is important to ensure that as many of the areas as possible, in which the capital accord initially maintains the possibility of national discretions, are removed over the years. This could be achieved by ensuring, for example, that transitional provisions are used in the areas in which national discretions will initially be possible under the capital accord.

3. Pillar 2:
Capital requirements according to pillar 2 should on average not be necessary since pillar 1 is calibrated to ensure a sufficient overall level of capital.

It should be made clear in the capital accord that additive capital requirements under pillar 2 are not in line with accurate risk assessment and are an overly conservative approach. Instead, it should be possible to offset additional pillar 2 capital requirements by over provisions against other risks, i.e. it should be possible to net pillar 2 capital requirements between under and over provisioned risks.

The potential for Pillar 2 to create competitive advantages/disadvantages for banks that compete on the same market cannot be ignored. Therefore it is very important that an international best practice is established, which supervisors are encouraged to contribute to and comply with.

4. Rating system design:
Danish Bankers Association would find it natural for the rules for 'exposures to corporates, sovereigns and banks’ laid down in points 358-362 to be applicable to retail exposures as an option for the individual institution.

The Danish Bankers Association is of the opinion that banks that have based their internal rating systems for retail on the same two dimensions (PD and LGD) as are required under IRB corporates, institutions and sovereigns should be eligible for IRB retail. This rating system structure is natural for banks, which take a customer view rather than a product view, and is thus important for many European institutions, including Danish ones.

In this context the product side and the collateral side are included in the LGD and the EAD rating. For banks taking a customer view, it would be highly unsatisfactory to have to develop alternative systems that estimate several different PDs for the same customer depending on the products the customer has with the institution.

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One of the reasons for this is that it would to a great extent be a question of interrelations between the customer's individual accounts (products), whereby empirical PDs are made dependent on both different customer/product mixes and the behaviour on the individual account. The relationship between the customer's individual accounts (products) makes a usable PD calculation per product impossible. The reason for this is that the behaviour on the individual accounts cannot be viewed independently. For example, the fact that a customer is having financial problems will almost always initially show in the form of an overdraft on an overdraft facility or other current account. The question is thus not whether it is, for example, the overdraft facility, the mortgage or the car loan that is being defaulted on, but rather the fact that the customer is in a default situation.

Viewed against that background, the wording of *point 363* should make room for the dissimilarities between the institutions rather than unnecessarily and inappropriately delimiting the minimum provisions.

5. Back testing:
The back testing requirements for approval of the banks' IRB models are good examples of areas in which a common best practise needs to be established.

Danish Bankers Association is of the view that back testing should be at a suitable overall level and not on individual sub-portfolio basis. This is particularly important in relation to the low risk classes, since these typically include a limited number of exposures, and therefore will be connected with considerable uncertainty when tested.

Kind regards

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