MINISTRY OF BUSINESS AND GROWTH
DENMARK

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 proposed 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.