FINANSTILSYNET
THE FINANCIAL SUPERVISORY AUTHORITY OF NORWAY

NORGES BANK

Basel Committee on Banking Supervision
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Comments on the Basel Committee on Banking Supervision's discussion paper entitled "The regulatory framework: balancing risk sensitivity, simplicity and comparability"

Joint comments from Norges Bank and Finanstilsynet (Financial Supervisory Authority of Norway)

1. General comments (Q1, Q2 and Q3)

The FSA of Norway and Norges Bank acknowledge the challenge of striking an appropriate balance between the goals of risk sensitivity, simplicity and comparability in the regulatory framework. The regulatory framework seeks to ensure financial stability and a resilient bank sector, and should foster sound risk management and efficient use of capital across different financial institutions and various business models. Improved risk management in itself increases banks' financial strength as risk-sensitive capital requirements should create incentives for banks to restrict lending to customers with low debt-servicing capacity and limited financial buffers. A framework built on risk sensitivity may therefore help to mitigate vulnerabilities in the financial system. Under less risk-sensitive regimes, banks have tended to undertake regulatory capital arbitrage, e.g. by concentrating lending in segments with high short-term returns that are not sustainable in the longer run. Consequently, adjustments to the capital adequacy framework should seek to maintain risk sensitivity of the framework.

Transparency is essential for the effectiveness of market discipline. The FSA of Norway and Norges Bank share the Committee's concerns about the complexity of the current regulatory framework and about the comparability of banks' capital ratios. As the current framework allows for various approaches to calculate risk weights, banks can apply substantially different risk weights for similar assets. Comparisons of reported capital ratios may thus give a misleading picture of banks' relative financial strength. Moreover, there are signs that market participants have lost confidence in banks' reported capital ratios. This may have material negative implications for the effectiveness of market discipline.

The FSA of Norway and Norges Bank support the notion of introducing simplicity as an additional objective for the regulatory framework (paragraphs 48-49). However, if complexity is largely driven by a desire for risk sensitivity, a simplification of the framework may result in less precise information and, in turn, make reported figures less comparable.

2. Specific measures that may enhance simplicity and comparability (Q4 and Q5)

The FSA of Norway and Norges Bank would like to emphasise the importance of the Committee's work on analysing the dispersion in the calculation of risk-weighted assets (RCAP). Better understanding of the drivers of dispersion provides a basis for regulatory refinements and standards that enhance the harmonisation of practices among banks. Furthermore, we also support measures that foster harmonisation of supervisory practices across different jurisdictions (paragraphs 67-69), while not limiting the possibility of adequate adaptation to specific regional or national considerations. National competence and reciprocity are necessary for the effective conduct of macroprudential policies.

The FSA of Norway and Norges Bank support efforts to enhance disclosure (paragraphs 50-53). The Pillar III reports of banks differ in terms of both content and format, and greater harmonisation is clearly needed in order to improve comparability.

The FSA of Norway and Norges Bank support the proposal to utilise floors and benchmarks to mitigate model risk (paragraphs 60-64). In Norway, the transition to Basel II has resulted in significantly lower risk weights for IRB banks, boosting their capital ratios. Leverage ratios have not increased by the same degree. The transitional Basel I floor has helped to curb the fall in Norwegian IRB banks' risk-weighted assets and maintain the actual amount of capital in the banking system. On this basis, we recommend that the transitional Basel I floor should apply.

The transitional floor is calculated differently across jurisdictions, and there are differences as to whether the floor applied relates to Basel I or the standardised approach. The FSA of Norway and Norges Bank would welcome further harmonisation in this area. However, if the floor is to be based on the standardised approach, it should be stricter than 80 percent, to prevent it from being less binding than the current Basel I floor (c.f. articles 45-46 in the 2006 Basel Accord). By replacing the Basel I floor with a stricter floor based on the standardised approach, the complexity of the current framework can be reduced and a reasonably level playing field between IRB banks and standardised approach banks can be supported. The floor on risk-weighted assets can be combined with stricter risk parameter floors. In any case, we consider that a recalibration of the risk weight formula to a more prudent level would be appropriate. Furthermore, it is our view that such a recalibration can be done within the motivation of the current formula, by increasing the confidence level for losses or shifting the correlation parameter formula (c.f. adjustments that the BCBS has undertaken for the correlation for exposures to large financial institutions).

Yours sincerely,

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