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The Ministry of Economic Affairs and the Interior in Denmark and the Ministries of Finance in Finland, Iceland, Norway and Sweden

Nordic cooperation on Basel III / CRD IV

The Nordic Financial Supervisory Authorities (FSAs) have received the Nordic Ministers of Finance's letter of 11 September 2012 with an invitation to evaluate the scope for Nordic cooperation on CRD IV. The letter was accompanied by a report from a high-level working group appointed by the Ministers of Finance.

The report identifies 3 key areas of cooperation that are crucial for an effective implementation of CRD IV in the Nordic area: liquidity standards, reciprocity and assessment of internal models.

The Nordic FSAs emphasise that the closely integrated Nordic financial markets call for close cooperation between the competent authorities when implementing and enforcing rules like Basel III/CRD IV.

Nordic supervisory cooperation

As underlined in the letter, the Nordic FSAs cooperate extensively both via discussions and information sharing between colleagues and in designated working groups and forums on several areas, i.a.:

Supervision of cross-border institutions: Supervisory colleges are established for the major Nordic banks.

Capital buffers in a cross-border banking group: A framework for assessment of capital buffers in a cross-border banking group was agreed by the Nordic supervisory authorities in December 2010. The framework provides an operational approach to the distribution of stress test buffers between the parent bank and subsidiaries in other Nordic countries.

Capital requirements and internal models: The Nordic Capital Adequacy Working Group, whose mandate is to promote "as far as desirable and possible, a harmonised regulation, supervision and reporting on capital adequacy" has served as a forum for capital requirements in general and internal models in particular, from the Basel II implementation and onwards. A specific working group was set up in 2011 to investigate differences in risk weighting among Nordic banks using internal models for credit risks (IRB models).

Macroprudential regulation: The FSAs and the Central Banks meet in the Nordic Baltic Macroprudential Forum i.a. to discuss and coordinate the development and adoption of macroprudential policy frameworks and to identify risks in the Nordic-Baltic area and possible responses to them.

Liquidity: A Nordic group was established in 2009 to work on CRD IV/Basel III liquidity requirements. The group, later extended to the Baltic countries, meets regularly to discuss current liquidity issues in the Nordic/Baltic region, including enhanced cooperation on the work in the European Banking Authority (EBA) on the coming liquidity standards. The group furthermore cooperates on the interpretation of EU and Basel Committee documents on liquidity risk and possible harmonisation of certain definitions; and to exchange experiences and data from liquidity reporting. In addition, a dedicated work stream on liquidity buffers was set up by the Nordic supervisory authorities in spring 2012. The aim of this work is to explore the possibilities within the framework of CRD IV for achieving the right balance between the host and home supervisory requirements in the allocation of these buffers.

Crisis prevention and resolution: In August 2010 the Nordic and Baltic Ministries of Finance, Central Banks and FSAs signed an agreement to enhance information sharing and coordination in order to reduce the risk of cross-border contagion of crises. A Nordic Baltic Cross-Border Stability Group has been established.

The Nordic FSAs also participate actively in the European supervisory collaboration under the auspices of the EBA, whose stated mission is i.a. to strengthen supervisory coordination and promote supervisory convergence in the EU/EEA area. In this context, we wish to mention in particular the EBA task force on consistency of outcomes of risk-weighted assets.

Common understanding of liquidity requirements

Noting the Nordic countries' different timelines for implementing the liquidity requirements, the report suggests common metrics used for different supervisory purposes, e.g. as minimum requirements in some countries and for monitoring or other supervisory purposes elsewhere. Though not completely harmonised, the reporting forms used in the Nordic countries for either all or samples of banks are based on Basel III. Uniform European LCR and NSFR reporting, planned by EBA from 2013, will contribute to further harmonisation.

Regarding the report's suggestion of a common LCR definition as "a basis for a coordinated Nordic approach with regard to influencing the efforts by the EBA and the European Commission to develop a common European LCR", it is worth noting that the Nordic FSAs take actively part in EBA's work on the technical standards specifying the liquidity requirements, with a particularly important role in the working on standards for currencies with constraints on highly liquid assets.

Reciprocity and host country regulation

For prudential measures taken on the national level to be fully effective, from the perspective of the host supervisor, they should apply to foreign banks' subsidiaries or branches. This is recognised in the CRD IV proposals, with reciprocity in areas like countercyclical buffer requirements and LGD floor and preferential standardised risk weights for exposures secured by property. In other areas, like specific and explicit measures taken to alleviate systemic or macro prudential risks within the framework of pillar 1, the Council proposes that authorities in one member state may decide that measures taken in another member state also apply to their institutions' activities or branches there (optional reciprocity).

Regarding the countercyclical buffer the Nordic Baltic Macroprudential Forum has initiated work to reach a common understanding of the indicators used in the different countries to calculate countercyclical buffers. It is not necessarily the case that one single method or the same type of data would be the most appropriate for all countries, but an understanding of the methods used is important for the mutual recognition of buffer levels in the Nordic-Baltic region.

The report also seems to indicate that a system of optional reciprocity could have a broader scope and encompass areas of national discretion generally, including the interpretation of the regulation. As the report points out, a reciprocity system has to be in line with the general rules for sharing of supervisory responsibilities, i.a. in supervisory colleges.

The Nordic supervisors consider it necessary to strive for further convergence of supervisory methods and practices in the Nordic countries. However, we believe that the best way to achieve convergence in the supervisory cooperation is through an intense and constructive dialogue. If automatic reciprocity is preferred, it should be included in the legislation.

Cooperation on criteria and practices in model approvals

Common understanding of the regulation is particularly important in the use of internal models for capital adequacy purposes. The European regulation is far-reaching in requiring supervisory cooperation since it allows a cross-border banking group to submit one single application (to the consolidating supervisor) covering the whole group, which will be assessed jointly by the home and host authorities. Therefore, when assessing model applications the Nordic FSAs have had an intense cooperation at the expert and management levels since even before the Basel II regulation came into force in 2007.

Furthermore, the Nordic FSAs cooperated in the Nordic Capital Adequacy Working Group to achieve a common understanding of key requirements and practices in the implementation of Basel II, and have subsequently discussed these issues when assessing particular models. Comparisons of Nordic IRB banks have demonstrated differences in both parameter estimates and the resulting risk weights between the Nordic banks, which in general reflect relevant characteristics of the individual loan portfolios. However, such differences may also partly be ascribed to differences in supervisory practices. The Nordic FSAs have thus

designated a working group for IRB comparisons to investigate these differences in further detail. Similar projects are initiated both on the international and European level under the auspices of the Basel Committee and EBA. In that regard it might be expected that further mechanisms for benchmarking IRB-model under the auspices of EBA may be introduced through the current trilogue negotiations.

The Ministers seem particularly concerned about IRB residential mortgage weights. Nordic FSAs address these concerns and consider measures to ensure sufficiently conservative capital requirements for these exposures. Some FSAs have taken or consider taking steps to increase the pillar 2 requirement where there is uncertainty about the models. Other FSAs consider measures to increase the pillar 1 risk weights.

As far as harmonisation is concerned, it is worth noting that the CRD IV itself implies an even higher degree of harmonisation, prescribing binding technical standards or guidelines on several aspects of IRB modelling, i.a. on supervisory assessment of the institutions' models. The Nordic FSAs are represented in several EBA groups responsible for drafting these standards.

Harmonised regulation and supervisory practices will not, and are not intended to, rule out all differences in risk assessments and weightings between banks. They will, however, clarify the requirements and objectives for the models, and over time contribute to comparability and transparency. At the same time, the international regulatory debate is becoming more critical in ensuring appropriate use of banks' internal risk models for the purposes of calculating regulatory capital, despite this being the cornerstone of both Basel II and Basel III.

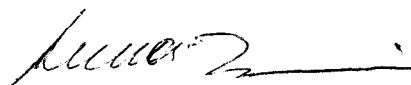
Conclusion

To summarise, several initiatives are already being taken both on Nordic and European level to address the highly important issues raised in the Ministers' letter. Further cooperation will take place within the existing framework for cooperation between the Nordic FSAs. The Ministries of Finance will be duly informed about future work on these issues.

Yours sincerely



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