



**MINISTRY OF INDUSTRY, BUSINESS
AND FINANCIAL AFFAIRS**

**MINISTER FOR INDUSTRY,
BUSINESS AND FINANCIAL
AFFAIRS**

Dear Executive Vice-President Valdis Dombrovskis

First accept my sincere congratulations on your appointment as Executive Vice-President for An Economy that Works for the People.

Thank you for the opportunity to respond to the consultation on the implementation of the Basel III standards.

Generally, we find that there are many reasonable and, in our view, positive adjustments in the recommendations from the Basel Committee on Banking Supervision (BCBS) (e.g. the changes to operational risk and IRB models for credit risk). However, we continue to have strong reservations in relation to the output floor, which has a number of adverse implications.

Most importantly, and although it is not the stated intention, the output floor could result in a decrease in the risk sensitivity in the capital requirements of financial institutions by effectively disregarding those internal models currently applied by the largest credit institutions in e.g. Denmark. The result is that credit institutions will have incentive to increase risk taking as they can take on more risky exposures without corresponding increases in capital requirements. In our view, this contradicts the fundamental purpose of the reforms.

Additionally, impact studies show that the Basel III package will lead to a substantial and unjustified increase in capital requirements, by e.g. increasing the capital requirements of the largest Danish credit institutions by approx. 40 percent. The output floor is the main contributor to this very significant increase.

An implementation of the output floor should preserve a risk sensitive approach in terms of capital requirements. The output floor should generally only work as a backstop to risk based capital requirements. This would not be achieved for Danish credit institutions with the calibration of the output floor proposed by the Basel Committee.

Denmark has been and continues to be a strong supporter of measures to strengthen financial stability. We firmly believe that financial stability is

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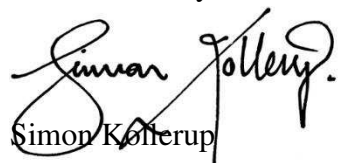
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best achieved through a risk sensitive approach to capital requirements, properly regulated and supervised. Therefore, we support the regulatory review of the IRB approach conducted by the European Banking Authority (EBA) with the aim of reducing unjustified variability in IRB models, thus ensuring comparability of risk estimates while at the same time preserving the risk sensitivity of capital requirements.

We generally think that any inappropriateness in the IRB framework should be addressed by improving the IRB framework instead of introducing a less risk sensitive capital requirement. Introduction of the output floor effectively suspends the models without taking the current functioning of the models into account. The substantial work already carried out by the EBA in the IRB area will go a long way towards improving the IRB framework. In combination with the changes in the IRB area as proposed in the Basel III reforms, we question the need for further measures such as the output floor.

We are looking forward to assisting you and the Commission services in the implementation of the Basel III standards in order to preserve risk sensitivity in the financial sector and ensure consideration of European specificities, in line with the Council conclusions from July 2016.

Yours sincerely,



Simon Køsterup