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Consultative document "Countercyclical capital buffer proposal" of July 2010
Additional comments from the Association of German Banks[1] (Bundesverband deutscher Banken e.V.)

Dear Madam, dear Sir,

We would like to submit the following comments in addition to the joint response by Germany's Zentraler Kreditausschuss (ZKA) to the consultative document issued by the Basel Committee in July 2010 on a countercyclical capital buffer proposal:

In principle, we support measures to mitigate procyclicality. We do not, however, consider the Basel Committee's proposal to introduce a countercyclical capital buffer an effective means of solving the procyclicality problem.

Our criticism of the planned capital conservation buffer applies here too – namely that market participants are unlikely to permit the release of capital from the buffer during a period of crisis. And if the accumulated capital cannot be drawn on, it will do nothing to dampen procyclicality. Furthermore, we consider the envisaged constraints on distributions of earnings to be massive and unacceptable interference in contractual agreements between banks and their investors.

[1] The Association of German Banks (BdB) is the leading association of the private banking industry in Germany and represents the interests of more than 220 member banks.

Admittedly, the creation of contingent capital instruments would at first sight appear a suitable method of building up a countercyclical buffer. Instruments which could be converted into equity at the beginning of a crisis would enable banks to have enough capital at their disposal to cushion against adverse economic developments. The problem as we see it, however, is that it would not be possible to place the required volume of contingent capital on the market because investor take-up would be insufficient.

Forward-looking provisioning, by contrast, represents a more sensible approach to mitigating procyclicality. We therefore support the initiative of the International Accounting Standard Boards (IASB) to revise IAS 39 and welcome discussion of how such provisions should best be built up. In our opinion, procyclicality should be tackled by requiring banks to make arrangements for expected losses on their loan portfolio. If the amount set aside to cover expected loss exceeds that required for incurred losses, the difference should be eligible for recognition as a regulatory capital reserve or buffer. This reserve could then be drawn on in a period of crisis to cover losses that actually occur.

The Basel Committee envisages that the countercyclical buffer will make capital available to protect against system-wide risk which may arise in periods of extraordinary credit growth. We do not take the view that systemic risk should be reduced by raising capital requirements. Instead, effective macroprudential supervision should be established to monitor systemic risk and take appropriate countermeasures where necessary. Credit growth can also be managed through central bank monetary policy, for instance.

Yours sincerely,

Dirk Jäger   Anja Schulz