

MEMO

Comments on Countercyclical capital buffer proposal

Finanstilsynet welcomes the opportunity to comment on the consultation regarding the committee's Countercyclical capital buffer proposal.

DANISH FINANCIAL
SUPERVISORY
AUTHORITY

10 September 2010

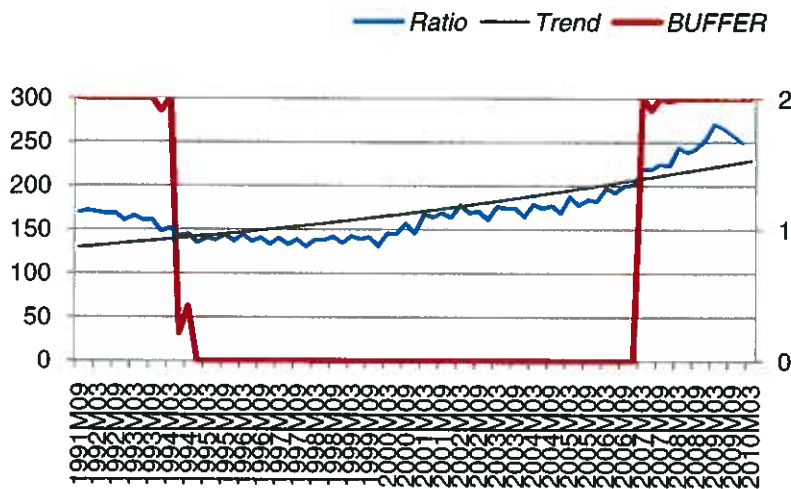
Finanstilsynet generally supports efforts to strengthen the resilience of the banking sector by exploring countercyclical measures. Moreover, we support the intention of permitting national authorities to apply some judgement in setting of the buffer in their jurisdiction.

J.no.
/jcn

Making the legally set capital buffer vary according to the economic cycle in a contra-cyclical way is desirable, but would on the other hand also add complexity and uncertainty to the system. Finanstilsynet is thus concerned with the importance of predictability and clarity about the counter cyclical element for capital buffers, since it is important for investors to have as much as possible transparency. As a consequence the framework for setting a buffer should be very transparent and harmonised across borders.

Finanstilsynet does not question the prudence of countercyclical capital buffers, however, the effect of adding the buffer in a period of excess credit growth is restrained by the period of 12 months in which banks are allowed to raise additional capital. The full counter cyclical effect of the buffer is thus added late in the cycle which hampers the effect of the proposal. As a result, we suggest shortening the time frame which a bank is given to raise its capital level to a period no longer than six months.

Evidence of the Danish market suggests that if a countercyclical capital buffer proposal had been applied in 2007 the full effect of the buffer would have been in place first quarter of 2008. Retrospectively, the buffer, set at 2 pct., would not have prevented a number of specific banks from defaulting, but the buffer would have succeeded in raising capital levels in general. Moreover, the now defaulted banks would have been restricted in their dividend payout in 2007.



Graph 1: The credit to GDP ratio for the Danish market.

Therefore, Finanstilsynet suggests the committee to consider supplementing the proposal with a countercyclical measure, which relates capital buffer decisions to the level of credit growth of the individual institutions. I.e. we propose to couple monitoring of aggregate credit growth/GDP to a regime which also monitors credit growth of those institutions, which display the highest levels of individual growth. Thus, banks which appear to be growing too fast relative to the growth/GDP factor, or in comparison to other banks, could in such a scenario be prone to an individual capital add on in addition to the macro countercyclical capital buffer add on.