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Countercyclical buffer proposal

Danmarks Nationalbank welcomes the opportunity to comment on the consultation regarding the committee's countercyclical capital buffer proposal. We support the aim of the proposal, namely to reduce systemic risk due to periods of excessive credit growth. We believe that the introduction of a countercyclical capital buffer which strikes the right balance between allowing for country-specific circumstances while ensuring transparency and similarity across jurisdictions will contribute to achieving this aim. Furthermore, the buffer must be efficient in providing clear incentives for banks to build up capital when credit growth is increasing excessively.

However, we have some concerns that the proposal does not sufficiently address these elements.

Firstly, whereas we acknowledge that there should be room for judgement in setting the buffer to take into account any specificities of a given situation, we have concerns that too much jurisdictional flexibility will lead to decreased transparency and an uneven implementation of the buffer across jurisdictions.

We therefore suggest that the proposal include more solid anchoring of the buffer decisions. This could include generally agreed upon criteria for the identification of the build-up of systemic risks (e.g. excessive credit growth), a generally agreed upon interval for the buffer zone and generally agreed upon criteria for the decision on the level of the actual add-on depending on the extent of the systemic risk build-up.

Secondly, we have concerns regarding the effectiveness of the buffer on ensuring build-up of capital in the banking system when credit growth is excessive.

In particular the proposal should emphasise that the level of the countercyclical buffer and the consequences of being in breach of the buffer should ensure a sizable effect on the build-up of capital in the banking sector as a

whole when credit growth is increasing excessively. In this regard we see a buffer of 2 per cent as used in the example in Annex 2 as being in the lower end. We also see a capital conservation ratio at 40 per cent (i.e. up to 60 per cent of earnings can be distributed) for banks in minor breach of the buffer as being in the low end. We suggest that further research is conducted on how binding the countercyclical capital buffer would have been going into the current crisis and how it would have affected the capitalization of the financial system.

Furthermore, we suggest that the time frame allowed for adjustment to an increase in the buffer set to 6 months instead of 12 months. This will ensure a closer synchronization of the countercyclical effect of the buffer and the credit cycle while maintaining headroom for banks to restore their capital should they no longer meet the requirements set by the buffer.

Yours sincerely,

Nils Bernstein