Deutsche Bank

15 September 2010

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB

Tel: +44 20 7545 8000

Direct Tel +44 20 7545 7471
Direct Fax +44 20 7547 4179

Mr. Stefan Walter
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

baselcommittee@bis.org

Dear Mr. Walter,

RE: Countercyclical capital buffer proposal

Deutsche Bank (DB) welcomes the opportunity to comment on the BCBS consultation on the design of a countercyclical capital buffer. We participated in the development of the Institute of International Finance's (IIF) detailed response paper which provides an extensive analysis of the challenges around the implementation of this proposal for industry. This letter is intended to underscore our high-level concerns on the proposal.

There is a clear need to address the procyclicality of Basel II by better reflecting the macro-prudential environment in the revised framework. We believe that this can be achieved most effectively through a combination of the forward-looking provisioning framework currently under development, through-the-cycle adjustments already put in place, and in Pillar 2 ICAAP assessment of the country and/or sectoral risk faced by individual institutions.

Forward-looking provisioning is, in our view, the best mechanism to dampen procyclicality. Combining forward-looking provisioning with a capital-based mechanism is a double counting of macro-prudential risk. It is also important to note that a number of elements of the proposed Basel 3 framework will have a procyclical effect, including the deduction of DTAs and the reliance on ratings in the liquidity risk management framework.

The proposed countercyclical buffer is, in our estimation, overly-complex and inoperable:

- The communication of capital adequacy to the public, to analysts and investors would become extremely challenging particularly for international banks. It is unclear how the buffer would be treated for financial reporting purposes and until this is agreed with the IASB and FASB, it is difficult to see how the proposal could be advanced.
- The proposed buffer would be a blunt instrument. Applying a blanket buffer to all institutions active in a particular jurisdiction, irrespective of which sectors are overheating in that jurisdiction, will penalise well-managed institutions and result in a roll-back of high quality credit. Rather than a one-size-fits-all treatment, supervisory colleges should decide how to act on macroprudential announcements as part of the Pillar 2 process.
- A buffer that is entirely at the discretion of national authorities, moving on a jurisdictional basis, will make internal capital planning impossible. Given that the buffer will be a moving target, it will be impossible to steer the bank using capital ratios. This raises serious doubts about the prudential validity of the proposal.
- It will also inhibit the bank's ability to carry out internal risk assessment under the ICAAP with any accuracy.
- Identifying the location of individual exposures would be extremely challenging, if not impossible. It is not clear what is meant by "exposure", how Trading Book exposures would be treated, how exposures to international corporations would be managed, or where the funds of any given exposure are actually employed.
- While basic information is already provided by institutions for the purposes of BIS data, it would not be possible to capture the level of data needed to properly

demonstrate that the right exposures are being captured for the purposes of the buffer.

The buffer will de facto become a minimum Core Tier 1 requirement:

- The 12 month period in which to raise capital after the announcement of a buffer add-on decision, as alluded to in footnote 5 of the CP, would be irrelevant given likely market reaction. Banks like DB operating in many jurisdictions would essentially have to treat the buffer as a minimum to avoid sudden market-driven fluctuations. It is not clear that this outcome has been factored into the QIS calculations or any other impact assessments.
- Even if this problem could be circumvented, it remains unclear whether the buffers could be used in times of need without damaging market confidence. If the release mechanism is not operable, banks will be forced to reduce lending sooner in a downturn. This would mean the buffer would have the opposite effect of that intended.

The CP acknowledges the challenges arising from the home-host cooperation that would be needed to make the buffer process function effectively. We are sceptical that the necessary level of cooperation can be achieved with this jurisdictional approach. The potential impact on emerging economies where international banks are active could compound the issues already arising from the deduction of investments in financial institutions. It is also not clear that a home country authority would impose a buffer on a large host country without jeopardising broader political relations.

Although the CP does not address the capital conservation buffer as proposed in December, we feel that there is still need for dialogue on its design. We continue to be concerned that a mandatory buffer framework dependent on cutbacks in dividends or employee compensation, may in fact damage a bank's ability to raise capital, and exacerbate rather than diminish bank risk. The framework as currently proposed does not adequately incentivise management actions that may be taken to diminish risk exposure and increase capital stability, nor is any leeway given for longer-term remediation measures such as strategic divestments.

The proposed buffer framework, comprising of the capital conservation buffer, the countercyclical buffer and a potential systemic institution buffer were confirmed in the 12 September announcement on calibration. We also understand from the press release that not only the capital conservation buffer, but also the countercyclical buffer will essentially be limited to Core Tier 1 equity. We feel it is premature to move forward with these proposals while a lot of clarification is needed around the practical details and consultation is ongoing on the loss absorbency of capital. In addition, not allowing the use of contingent capital instruments and other innovative capital instruments for use in the buffer, will push the Core Tier 1 ratio for large institutions from 2% to near 10%. Even given the generous phasing provisions announced last weekend, it is questionable whether investor appetite exists to achieve this goal.

We believe more dialogue is needed to ensure procyclicality can be addressed in a prudent manner and look forward to ongoing dialogue in these issues in the coming months.

Yours sincerely,

Andrew Procter
Global Head of Government & Regulatory Affairs
Deutsche Bank AG