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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Basel Committee Secretariat:

We are pleased to submit our response to the Basel Committee's Consultative Document on the "*Countercyclical Capital Buffer Proposal*." We have reviewed the proposals, considering the nature and level of activities being conducted by financial institutions in our jurisdiction as well as the potential impact of the proposed reforms on the resilience and stability of global financial sector.

We have provided general commentary to the proposals in this covering letter and a more detailed list of concerns, following the order of the documents, in an Appendix. We hope you find our comments useful.

General comments

While appreciating the need to act quickly and meet the agenda set by G-20, it is of vital importance that the proposed Countercyclical Capital Buffer (CCB) framework be developed and implemented in a flexible manner allowing for the specific characteristics of different national markets. It is essential that the framework leads to triggers based on appropriate and leading macro-economic indicators so that the triggering of CCBs occurs at the right point in the credit cycle. A high level of emphasis should be placed on developing processes and guidance to help supervisors communicate the triggering and release of CCB requirements to ensure that the impact on the subject banks and wider financial system are smooth and to provide the right expectations to markets. It is also vitally important to ensure availability of enforcement mechanism to ensure that the home-host reciprocity in implementing CCBs levied by host supervisors of branches is accepted by home supervisors.

The rationale for adopting a set of countercyclical micro- and macro-prudential measures to temper the cyclicality of extreme circumstances in credit cycles is well founded and consistent with the general objectives to promote a robust, global financial regulatory framework. As we understand, the countercyclical buffer proposal aims to identify a single or a combination of macro-economic variables, like credit-to-GDP ratio, to trigger the

application of a countercyclical capital buffer (CCB) as well as determine the size of such a buffer.
This approach is based on the assumption that the trends or cyclicality in identified macro-economic variables for the operation of the CCB are well correlated with capital adequacy levels in individual banks. As individual banks vary widely in their risk tolerances and capital management policy, a common buffer levels for all banks in a jurisdiction, triggered by a macro-economic variables, might result in unintended consequences. We believe that micro-prudential measures and pro-active supervision are likely to be more effective in enhancing the countercyclical effect of the proposed capital buffer.

Instead of using a macro-prudential measure such as credit-to-GDP ratio or other similar measures to apply an approximate and subjectively assessed buffer across the banking sector, it would be more effective to focus on fine-tuning bank-specific capital requirements. Although the paper makes it clear that the dampening effect of CCB on credit growth is only a secondary benefit form the proposed CCB, we believe the CCB is more likely to immediately arrest credit growth. This will have a time-lagged monetary policy affect on the banking sector. We also believe the Consultative Document should back-test its affect on a variety of jurisdictions to determine when the CCB would have taken effect over the past 5-10 years in the lead-up to the financial crisis.

Triggering the CCB at inappropriate points in credit cycle can have unintended consequences, as explained later in detailed comments. Since the proposal provides 12 months for banks to meet the additional capital requirements, the effect of the CCB will be counterproductive from a macro-economic policy standpoint. Also, it is important that the trigger for the proposed CCB is based on a leading indicator, rather than on a concurrent indicator or ex-post measure like credit-GDP ratio, which would result in the CCB being triggered well before the peak in credit cycle. In that event, slowdown in credit growth and bolstering of capital will occur before the economy hits the peak of credit cycle.

In addition, it is difficult to envisage a trigger for CCB which is based on a single macro-prudential measure though it is based on a rigorous and consistent international standard. An effective trigger needs to be based on a combination of leading indicators, which are appropriate to the economy and the financial system for which it is developed and calibrated appropriately. It is also essential that the global framework for CCB provides the required level of flexibility for individual jurisdictions to implement CCB in a proportionate and appropriate manner, considering the idiosyncratic features of banking sector and economic structure of that jurisdiction.

Yours sincerely,

Paul Koster
Chief Executive

Annex: Specific comments

Introduction & objective

- We agree with the expected secondary benefit of moderating credit growth with the implementation of CCB. In fact, we believe that the immediate effect of such a buffer would be to curb credit growth for all banks and credit institutions, by varying degrees depending on their excess capital over regulatory requirements.
- We appreciate the need for the CCB framework to be accepted and implemented as an internationally consistent instrument available at the disposal of national authorities. But, to be effective, this tool needs to be promptly and effectively deployed by local authorities as and when the defined triggers are activated. The difficulties in achieving consistent implementation can arise from many aspects as detailed in the following sections of this document.
- The administrative and cost burden to develop and implement an internationally consistent CCB standard, including the trigger model/measures, monitoring system, review of the measures in a periodic basis involve are likely to be considerable, particularly for the large majority of emerging markets and developing countries. If the framework is not implemented effectively by some of the countries for the sake of cost and administrative implications, it would lead to undue competitive advantages for domestic banks in those countries against foreign banks from countries which have implemented the CCB framework. This would have the undesirable effect of directing credit business to a particular set of banks.

National buffer decisions and jurisdictional reciprocity

- We are in agreement with the proposed lead time of 12 months for shoring up required capital to meet the additional CCB requirement, if triggered. But, the timing of the trigger event will be a challenge with the level of difficulty being related to the measures used to identify the trigger as explained earlier in this document. Similarly, it is very important to release the CCB requirement immediately upon evidencing slowdown in credit growth or any other risk measure used to monitor aggregate systemic risks.
- On both occasions, it is important to take the decision at the right time as inappropriate timing can have unintended consequences, depending on the point in the credit cycle at which it is triggered. If CCB is triggered at or close to the peak of the credit cycle which is assumed to be correlated to economic cycle, the banks will be forced to reduce or stop credit growth while the economy is slipping into a downtrend or recession, precisely when the economy needs more credit delivery. Conversely, when the economy has slipped into downward trajectory, it is important to release the buffer to absorb losses and to sustain lending required for the economic recovery. Failure to

do this promptly would cause additional damage to the economy and consequently to the banks in terms of additional credit losses.

- In practice, this kind of coordinated action initiated by the authorities in a jurisdiction could trigger other problems. For example, if CCB is triggered, all or most banks would be expected to raise capital from the markets over the following 12 months. This is likely to lead to capital shortage over the subsequent 12 months when potentially capital markets could be weak due to downturn in the economy having already materialised. The consequent capital shortage can squeeze the capital needs of other sectors of the economy as well.
- National authorities might be discouraged from triggering CCB requirements, due to any of the following reasons: macro-economic implications on economic growth or managing an economic recovery, competitive issues for domestic banks vis-à-vis foreign banks, local political considerations like scheduled elections, pressure from local banking industry on the basis of additional undue burden.
- The proposal has not outlined any measures or incentives to motivate national authorities to ensure that the proposed framework will be implemented and acted upon as and when required. Failure to achieve uniform implementation of the proposed CCB across all national jurisdictions will result in competitive inequalities between domestic banks and foreign banks and between international banks operating in a third country. Such inequalities and resultant undue competitive advantages will lead to pressures from the industry in jurisdictions which have already implemented CCB to dilute the CCB framework in their country.

Common reference guide and principles to promote sound decision making

- It is critical to include in the principles defining the proposed CCB framework a requirement to ensure that the CCB framework is reviewed and adjusted in the context of structural changes to the economy or to the banking sector in an economy at least over the medium term, say once in 3 years.
- We are in agreement with the suggested approach which emphasises development of a CCB trigger suitable to the particular jurisdiction, though the suggested credit to GDP methodology is seen as effective for most of the markets as per past data. As referred earlier, it is vital for every jurisdiction to come up with a combination of macro-economic variables or a model which would reflect all the idiosyncrasies of the domestic economy, structure and profitability dynamics of the banking sector in that country and any other relevant factors.

Principles underpinning the role of judgement

- We agree with the emphasis on the timing of the buffer release decisions, considering the variables used in triggering CCB in the first place and point of time in the credit

cycle. Any delays in the timing of the release could potentially negate the intended benefits of the CCB framework by constraining regulatory capital from spurring required credit growth when the economy is going down.

- It would be useful to national authorities implementing CCB, if more information and guidelines are provided on the process and variables to initiate prompt release of CCB based market indicators of stress so that capital is released as soon as stress is seen in the economy. In the same way, additional guidance on communication strategy for disclosing information on duration and extent of the CCB release to the wider market would be useful. Such disclosures would also help bank managements in their capital management decisions.

Calculating bank specific buffers

- The consultation document is surprisingly silent on the rationale for excluding credit to public sector in deciding on the buffer requirement. If a global bank is to calculate weighted average of the buffer requirement in every jurisdiction where it has exposures, it is reasonable to include jurisdictions where it has exposures to public sector entities including sovereign or quasi-sovereign entities. Considering the trend in credit quality of several such public sector entities over the last 12 months, there is no basis for excluding them from the calculation methodology for the CCB requirement.
- The argument presented in the consultation paper on the expected behaviour of internationally active banks in credit delivery across different markets where they operate cannot be substantiated and lacks logical robustness.
- In the proposed framework, internationally active banks which operate in many countries will find themselves in an advantageous position in markets where the CCB imposed is higher than the weighted average CCB applicable to that foreign bank. The resultant additional credit capacity for that foreign bank is often a clear competitive advantage as banks often use ability to provide credit as an effective competitive factor to break into markets or increase market share, sometimes even at the cost of those deals being unviably priced. So, there is minimal evidence to support the contention that lending decisions by banks are always driven by marginal cost of credit in a particular jurisdiction. In fact, this could be a significant source of competitive inequality between domestic banks and foreign banks if the CCB suggested for a particular jurisdiction turns out to be very high compared to other markets in which the foreign banks operating in that country also operate.

Location of the buffer

- The proposed arrangement for implementing CCB in respect of branches needs to be strengthened in respect of mandate of home supervisors to ensure levy of CCBs required by the host supervisors of all jurisdictions in which the particular bank operates. This is likely to be a significant issue for branches as capital can effectively

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be held only in the home jurisdiction. The reciprocity provisions referred need to be elaborated and the mechanism by which BCBS hopes to ensure that the CCBs levied on branches of a bank, by its host supervisors are accepted and used by the home supervisors in arriving at the regulatory capital requirements for a bank need to be effective.

- At the same time, it is essential to ensure that host supervisors do not use the CCB as a protectionist barrier or competitive threat on foreign banks operating in their jurisdiction as branches. The host supervisors can achieve this by arbitrarily changing the methodology of calculating CCBs resulting in higher CCB which would unduly increase the cost of credit put pressure on the profitability of the foreign bank, particularly if it happens to be a significant operation of the foreign bank in question.