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

10 September, 2010

To Whom It May Concern,

In response to consultative document released on 16 July 2010, titled "Countercyclical Capital Buffer Proposal," we hereby submit our opinions.

1. With Respect to Regulatory Consistency (Equity)

The proposal is deemed to lack consistency as it forces only banks to set aside extra counter-cyclical capital and fails to count in non-bank financial institutions that spark an excessive supply of credit.

Furthermore, as it fails to mirror the differences among banks resulting from different policies to respond to the economic cycle, this requirement may work as a setback for banks carrying out a public policy role.

The likelihood is that banks will orient towards relatively safer and more lucrative mortgage loans while squeezing corporate lending.

2. With Respect to the form of Capital Buffer

To maximize the capacity to absorb losses in the event of crisis, contingent capital should be recognized as capital buffer.

However, as conditions for the issuance of contingent capital vary from one country to another depending on the maturity of each local capital market, the plan should be put forward with meticulous care. In addition, it is against the purpose of contingent capital that the capital hinges more heavily on the maturity of a capital market than the financial conditions of the bank such as its ability to deliver profits or to manage risk.

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3. With Respect to the Operating Method

It is critical for the central bank and the banking supervisors to come up with the clear-cut, transparent supervisory discretionary index other than Credit-to-GDP Gap.

Should the regulators seek to additional expansion of credit supply through the capital buffer without giving due consideration to the extent of the central bank's accommodative policies responding to a financial crisis, excessive policy effects could take place and unintended consequences such as the creation of an asset bubble might occur.

(Reference) IBK's Stance on the Supposed Effects of the Capital Buffer to Reduce Banks' Sensitivity to the Economic Cycle

1. An opinion regarding its function to avoid credit crunch during an economic recession

Banks will be reluctant to use the capital buffer in reserve in the face of an uncertainty where crisis that may last for an extended period of time.

- The use of the capital buffer may send out a false alarm throughout the capital market, causing investors and depositors to sell corresponding bank's stocks and to withdraw deposits.

Investors and depositors are highly likely to demand banks to keep their capital reserves well above the regulatory minimum even in an economic crisis.

- Korean banks' BIS ratios ranged from 10 to 12 percent even amid financial meltdown in 2008, outstripping the minimum capital requirement of eight percent.

As such, it is critical to make it clear to the market that the use of capital buffer does not necessarily involve asset quality deterioration. Further, it is necessary to give incentives to banks that tap into capital buffer in lieu of credit tightening (for instance, an exemption from the requirement to reserve buffer capital for the coming one year).

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2. An opinion regarding its functions to curb credit expansion during expansionary economy

The move to raise and hold extra capital during a cyclical upturn will lead to an increase in idle money, which is highly likely to initiate the shareholders' strong opposition.

If earnings from the additional extension of loans are projected to exceed the costs of building up capital buffer, then banks are more likely to expand their loan base aggressively.

Therefore, it is recommended to undergo adequate discussions with individual banks before setting capital requirement in the time of expansionary economy.

Feel free to contact the risk review officers provided below for any support you may need. We hope that our comments would help you to fine-tune the proposals, and would like to express our sincere appreciation for your hard work for the development of the financial industry.

Sincerely yours,

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