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Basel Committee on Banking Supervision
Via email baselcommittee@bis.org

Date 10 September 2010
Reference BR1227\6

Subject: NVB reaction to BCBS 172 - Countercyclical capital buffer proposal

Dear Sir / Madam,

On behalf of the Dutch Banking Association[1] (NVB), I would like to thank you for giving us the opportunity to provide you with our feedback on consultation paper 172, '*Countercyclical capital buffer proposal'.* We also draw your attention to the feedback submitted by the Institute of International Finance (IIF) and the European Banking Federation (EBF), which we both support.

The proposals put forward in the consultation paper represent an important element of the deliverables that were outlined in '*Strengthening the resilience of the banking sector*'. Dampening excessive credit growth by requiring banks to add funds to a countercyclical buffer in benign economic environments, can be an effective tool to dampen procyclical effects of banks' provision of credit to the economy, be it via the capital side instead of altering the provisions themselves. High quality internal risk management also addresses the issue of procyclicality. We welcome the work that has been done by the Basel Committee in this area and hope our feedback will provide a helpful addition to the discussion.

Countercyclical capital buffering interacts with banks' ICAAP process, as cyclicality is also addressed by banks in that area. Given this interaction, it is probable that banks will need to adjust their ICAAP processes.

In our view, a system for countercyclical capital buffering should be practical to use, easy to understand and – most importantly – should be workable in practice. This is exactly where things become complicated. Although the concept has an intuitive appeal, the practical set-up provides the potential for the introduction of complexity. There are various reasons that might warrant adding complexity to the system to address certain conceptual shortcomings. We will discuss some examples in our detailed feedback.

[1] The Nederlandse Vereniging van Banken (NVB) is the representative voice of the Dutch banking community with over 90 member firms, large and small, domestic and international, carrying out business in the Dutch market and overseas. The NVB strives towards a strong, healthy and internationally competitive banking industry in the Netherlands, whilst working towards wider single market aims in Europe.

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The proposal asks supervisors to provide an assessment of the state of the economy. This means that - next to the requirement of being a high quality prudential supervisor - a requirement is also introduced for the supervisor to become a good macro-economist. Although the Basel Committee underscores that it is not the intention to use the instrument to manage economic cycles, this is exactly what the consequence of its use will be. The result, therefore, creates a fundamental deviation from the supervisory framework in countries where the supervisory- and the central bank duties are segregated. Different national interpretations -which will be hard to avoid- create level playing field concerns.

A key element for the buffer to achieve its intended purpose is that it should not be regarded by stakeholders as being a part of the 'regular capital buffer'. Banks that have been required to hold a certain buffer amount for an extended period of time could be faced with stakeholders that grew accustomed to the high level of capitalisation. If it is decided to release (part of) the countercyclical buffer in such an environment, stakeholders could perceive the bank as being less stable. This could be the case even though the bank has become more resilient due to the higher capitalisation as a result of tightened requirements (even after the buffer has been fully released). This slightly counter intuitive release mechanism needs to be made very clear, in order for it to become a success.

Therefore, the Basel Committee, together with the Banking Industry should articulate clearly that building up a buffer or releasing the buffer will have consequences for the 'headroom' (i.e. difference between capital required according to the rules and the capital that is actually on the balance sheet). Nevertheless, once a buffer release kicks in, the change in the headroom is not expressing a change in the creditworthiness of the Bank; a change in the ratio true capital on the balance sheet versus true risk profile does.

The proposal put forward by the Basel Committee focuses on excess credit growth generated by banks. However, the provision of credit is not performed exclusively by banks, but also by unregulated financial companies, funds, etc. The proposal does not pertain to these types of companies and could put banks at a competitive disadvantage. The effect might simply be the shifting of risk from regulated entities to non-regulated ones. We urge the Basel Committee to address this concern, as this outcome should not be the end result of this proposal.

As a final point, the capital conservation buffer would not assist in addressing procyclicality, as this is a de facto increase of the minimum capital requirement.

In the annex, a number of practical questions will be covered.

I hope our feedback will be helpful to you. Should you have any questions or remarks, please feel free to contact me at your convenience.

Kind regards,

Onno Steins
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Detailed remarks

As announced in the cover letter, we will now discuss a number of questions relating to the actual implementation of the countercyclical buffer. The answers to these questions might warrant adding complexity to the framework. However, this should not be done right from the introduction of the proposal. As the concept of countercyclical buffering is new, we prefer the introduction of a version that is as simple as possible. This will allow the stakeholders to gain experience using a relatively comprehensible approach, adding details where required after experience has been enhanced. A ‘pre-evaluation’ under pillar II might be a valuable tool in this respect.

With regards to the implementation, we would like to raise the following questions:

1. When calculating the countercyclical buffer requirement, should the country of incorporation of the obligor or the ultimate risk country (more detailed definition to be determined) be used?

2. A number of corporate clients usually take out a loan centrally, aiming to redistribute it via its internal treasury. Should this loan be calculated according to the jurisdiction of origination, or should the calculation be split across the countries where the loan is allocated? If so, this would require the client to provide this information to the bank.

3. How should a guarantee be taken on board that applies to credit provided to one client, where the loan applies to multiple jurisdictions?

4. Especially in the case of emerging markets, there might be insufficient economic data available to estimate the point in the economic cycle. How should the countercyclical buffer requirement be calculated for such a jurisdiction?

5. The proposal depends to a large extent on the way prudential supervisors shape their assessment of the buffer requirement. This creates an unlevel playing field if the calculation and estimation methods used by the regulators are not aligned. How will the level playing field be safeguarded?