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OCBC Bank

David P. Conner
Chief Executive Officer

8 September 2010

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

Dear Sir/Madam,

COUNTERCYCLICAL CAPITAL BUFFER PROPOSAL

1. We refer to the Basel Committee on Banking Supervision's consultative document on Countercyclical Capital Buffer Proposal dated 16 July 2010 and the invitation for comments on the proposal.

2. Oversea-Chinese Banking Corporation Limited ('OCBC Bank') welcomes the opportunity to review the proposal, which sets out the approach and consideration of introducing a countercyclical capital buffer to achieve the broader macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth.

3. **Our overall view is that the proposed countercyclical capital buffer is a blunt measure which should not be prescribed and imposed on banks** as it is a one-size-fits-all requirement without considering individual bank's business model, risk profiles and operating environment. This could lead to a number of unintended outcomes, e.g., banks taking on additional risks to earn acceptable return on the excess capital they are forced to hold, additional capital costs being passed through to the economy by raising prices of banking services and capital being diverted to the unregulated financial intermediaries as banks become relatively less competitive.

4. In Singapore and some other countries, there are already fiscal, monetary or macro-prudential measures that are being or have been put in place to slow down excessive credit growth and prevent asset bubbles. Some examples of these measures include restriction on loan-to-value ratios, imposition of maximum financing quantum for real estate lending and increase in stamp duties to deter speculative transactions. It is therefore inappropriate to layer a blunt measure like a countercyclical capital buffer on top of these measures.

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5. **The current Basel II Pillar 2 framework already provides for stringent supervisory review of banks to ensure adequate capital levels are maintained under expected base case as well as stressed conditions.** Regulators have ample flexibility to require banks to take prompt corrective actions if they are not satisfied with the banks' capital adequacy positions and risk management practices. Addressing this requirement under Pillar 2 also clearly places the onus of ensuring capital adequacy under the responsibility of a bank's senior management and board of directors. This provides the right incentive for banks to invest in improving their risk and capital management capabilities tailored to their desired business mix and strategies. **For more effective and consistent use of Pillar 2 by regulators in different jurisdictions to strengthen the resilience of the banking sector, we propose that the Basel Committee facilitate the development of a harmonized set of Pillar 2 supervisory review principles and standards.**

6. However, if the Basel Committee still chooses to implement a countercyclical capital buffer, our comments on the proposals are set out below for the Committee's consideration:

   a) The proposal is intended to address only one out of the four key objectives set out in the December 2009 consultative package; the other three objectives are to (i) dampen excess cyclicality of Pillar 1 minimum capital requirements, (ii) promote more forward-looking provisions and (iii) introduce a capital conservation buffer. While our preference is to provide comments on this proposal after holistic consideration of other proposed changes and final calibrations of Pillar 1 capital minima, we note that these proposals and calibrations would be announced at a later stage. We therefore urge the Basel Committee to consider the subsequent calibration of the countercyclical capital buffer taking into account the aggregate effects and possible overlaps from these proposals and capital minima.

   b) **A Pillar 1 approach would turn the countercyclical capital buffer into a one-size-fits-all requirement, which is inappropriate as it does not reflect individual bank's unique business model, risk profile and regulatory environment.** For example, a bank that lends to targeted segments and does not participate in the excessive credit growth in its economy will be unfairly punished with higher capital requirements and consequently lower return on equity. This may result in banks attempting to compete aggressively for loan growth, thus ironically raising systemic risk which the proposal is intended to prevent.

   c) The countercyclical capital buffer should not be applied on total risk-weighted assets (RWA) as banks would not have priced in the *ex post* effects of any countercyclical capital buffer. Banks typically manage their balance sheet and pricing taking various factors into consideration, including capital cost. Imposing an additional *ex post* capital cost will distort the economics of banks' credit portfolios, generate unnecessary uncertainties and worse, create systemic risk as some banks may aggressively run up their loan books to be ahead of

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competitors. To avoid such unintended implications, **we propose that the countercyclical capital buffer be applied on incremental RWA from new/ additional credit growth based on certain reference date, which is in line with the fundamental intention of the countercyclical capital buffer to curtail excessive credit growth**.

d) **It is essential that capital buffers can be reduced on a timely basis** which, in practice, may be difficult to achieve. We are concerned whether regulators would be prepared to reduce and allow banks to run down on their countercyclical capital buffer during downturns, given the natural tendency to derive comfort from higher capital ratios in such situations, which may in turn compound the impact from a downturn by constraining the supply of credit. On the other hand, imposing a buffer too early in an economic recovery would also threaten a recovery. In practice this will require an objective formula-based approach to allow banks to draw down on such buffers during periods of stress and conversely, build up adequate buffers during benign periods.

e) **We are concerned over the proposed multi-layering of capital buffers**, i.e., the countercyclical buffer is intended to 'sit on top' of the capital conservation buffer and minimum capital requirements, which could result in possible overlaps in capital buffer requirement. The requirement that banks have to maintain capital ratios above multiple capital buffers in order not to be constrained in earnings distribution would disadvantage banks vis-à-vis the unregulated financial intermediaries, e.g., in terms of dividend payout and discretionary bonus payment. This will result in capital and the best talents being diverted into the shadow banking system. Such diversion could also have unintended consequences for financial systems and economy at large if banks were to undertake higher risks in order to achieve acceptable return for shareholders and raise compensation levels to retain top talents.

f) A prescribed approach to determination of capital buffers may also lead to an unintended transfer of responsibility for capital adequacy management from bank management and board to regulators. **We recommend that the Committee allow banks to address the various capital buffer requirements holistically under Pillar 2**, which are subject to governance oversight by the bank management and board as well as supervisory review by local regulators. Furthermore, the proposed capital conservation and countercyclical capital buffers would have been considered by banks in their capital planning under ICAAP, where appropriate internal capital buffers would be maintained to ensure capital adequacy under their planned credit growth rates and to meet any additional capital needs under stress.

7. In view of the far reaching consequence of the proposed capital reforms, **regulators should work towards implementing the final capital rules on a global scale to avoid an uneven competitive playing field across jurisdictions and potential regulatory arbitrage**. Local regulators should also not impose additional capital buffer requirements for banks in their jurisdictions.

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8. Our comments on the specific aspects of the countercyclical capital buffer proposal are included below for the Committee's consideration:

   a) There should be a clear definition of country of ultimate risk for the determination of geographic exposures to avoid uneven application of the countercyclical buffer proposal.

   b) In the determination of geographic composition of an internationally active bank and if necessary the disclosure of the composition, we suggest that a materiality threshold be established for the credit exposures in order not to impose unnecessary operational burden of having to adopt a look-through approach to allocate immaterial exposures to different countries on an ultimate risk basis. The materiality threshold and buffer add-on for exposures below the threshold can be set by the relevant home authorities.

   c) We note the requirement for the disclosure of individual bank's geographic exposures and countercyclical capital buffer under Pillar 3. While we are agreeable with the general intention of Pillar 3 disclosure, this should be limited to disclosure of information which can be readily comparable across different banks and understood by market participants. There should not be any disclosure of proprietary information, e.g., overall bank-specific capital buffers, which could undermine a bank's competitiveness in various areas, e.g., pricing, funding, capital raising, etc.

9. For information on OCBC Bank, please visit www.ocbc.com or refer to the Bank's comments on the December 2009 consultative package on capital and liquidity reforms (attached herein for easy reference).

Yours faithfully,

Copy: Ms Goh Gin Choo
Director, Complex Institutions Supervision Department
Monetary Authority of Singapore