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# Countercyclical Capital Buffers

The Austrian Federal Economic Chamber, Division Bank and Insurance, as the legal representative for all Austrian credit institutions, takes the following position with regard to the recent proposals for the operation of countercyclical capital buffers:

**General:**

First, we wish to state that we support the intention to rein-in procyclical effects in principle. However, proposals to increase the burden beyond the existing buffer are not sustainable, as this would result in adverse effects, including a reduced ability on the part of businesses to take on financing loans, and must therefore be rejected. Any buffer add-on will further aggravate the detrimental effects for the real economy.

- If the debate is about an additional buffer, the same criticisms as for buffers apply by analogy. These include the following points:
    - A buffer further restricts the bank's flexibility in managing its own funds and other measures related to business policy beyond the existing legal limitations, such as dividend payout restrictions.
    - Dividend payout restrictions, which are difficult to predict, make the bank's securities less attractive to investors, making it more expensive for banks to raise equity.
    - Issuing equity instruments is particularly difficult for banks that find themselves in a restrictive capital situation. This may jeopardise the bank's attempts at recapitalisation, which may otherwise be a relatively simple matter, and thus bring about the consequences the buffer was intended to prevent.
    - At the very least, potential large-scale borrowers will switch to alternative capitalisation measures offered in the capital markets (e.g. corporate bonds).

Companies who cannot fall back on these alternatives may find their financing capabilities curtailed. This would put the EU area, which has traditionally been credit-financed, at a competitive disadvantage.

- **Constant fluctuations in minimum capital requirements**
  The fact that the buffer is set separately for each bank based on its exposures in various countries causes the minimum capital requirement to fluctuate constantly (depending on the geographic composition of its portfolio and each country's decision as to the size of the buffer). This diminishes the level of transparency and makes it very difficult to plan for capital adequacy.

- **Difficulties with buffer administration**
  Defining the risk-relevant country of residence for each borrower on an ultimate risk basis incurs a large amount of administrative work. Since the country of residence is often somewhat ambiguous, this could result in protracted clarification processes with the supervisory body if there are differences in opinion between the bank's internal risk management department and the supervisory authorities. Internal risk management may even be affected if certain aspects of the RWA burden need to be taken into account when categorising borrowers. Particularly for an instrument that according to the Basel Committee’s statements is intended to be used rarely, this results in a situation in which the administrative work is disproportionate to the desired effect.

- **Supervisory arbitrage**
  It is unclear how the obvious problem of possible arbitrage between economies with different buffers will be managed. A “competitive pressure” of sorts could arise between authorities.

  In addition, different buffers cause potential competitive disadvantages for banks whose exposure is focused on certain countries or regions. Internationally diversified banks, by comparison, will be required to adhere to lower average minimum capital requirements than their competitors with a regional focus.

- This creates an incentive to avoid higher capital requirements by transacting certain deals in countries that are not part of the buffer system. Moreover, it is to be expected that large customers will choose to obtain loans in another country if the loans become more expensive in the home country. Such behaviour can lead to undesirable, uncontrollable loan migrations.

- **General buffer guidelines**
  Such a solution would not take into account the different levels of development in developing markets (e.g. CEE), which by nature have a greater need for financing loans. Therefore the same triggers cannot be used here.

  Furthermore, the home authorities could set higher buffers for host countries they deem to be at higher risk, thus interfering strongly with the business activities of a credit institution (CI), which would be likely to cause competition problems.

- **Credit-to-GDP indicator**
  The credit-to-GDP ratio proposed by the BCBS, which is compared to a long-term trend to calculate the credit-to-GDP gap, does not appear to be a suitable parameter for all

economies. Particularly for emerging markets, such as many of the CEE economies, this parameter does not serve its purpose since the credit-to-GDP figures are likely to deviate significantly from the trend, as is natural for emerging markets. If this parameter is used, bank groups operating in these markets will be severely penalised. The BCBS should explicitly consider the emerging markets and recommend more suitable parameters for these markets.

- **Coming into effect**
  To allow for a proper assessment of the consequences, the effects and modus operandi of this newly proposed system should be subjected to a monitoring phase lasting at least one full business cycle before it is written into the current legal framework. Premature implementation could lead to serious friction in the entire system. Once this monitoring phase has been ended, sensible deductions can be made that will withstand legal implementation.

- **Minority interests**
  The proposal seems to run counter to the recently proposed treatment of minority interests: while the one proposal penalises overcapitalisation above the legal minimum capital requirement at the local level, this proposal explicitly requires it.

- **Definition**
  It is difficult to imagine that a uniform definition and interpretation of what constitutes excess credit growth can be arrived at in the real world. The recent past has shown that it is frequently the ex-post rather than the ex-ante analysis that yields the relevant indicators. For a useful definition, a statistically significant "crisis forecasting model" would need to be developed.

- **Data availability**
  We doubt whether suitable long-term time series data exists for the calculation of the credit-to-GDP parameter, particularly for the trend calculation. Further specification as to how to deal with this problem is necessary.

- The decision of one country's supervisory authority to increase the buffer could counteract efforts to increase the stability of the financial markets. The announcement of such an increase sends a signal of potential overheating and bubble formation and may prompt investors to retract, leading to an unintentional bursting of a bubble by accelerated capital outflow.

- **Pricing / control of margins**
  The proposals would also be highly detrimental to revenue management.

We ask that our comments be taken into account.

Yours sincerely,

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Division Bank and Insurance