POSITION PAPER

WSBI-ESBG Position regarding the Basel consultation on a "Countercyclical Capital buffer proposal" (BCBS 172)

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The World Savings Banks Institute (WSBI) and the European Savings Banks Group (ESBG) appreciate the call for contributions to the Basel Committee's consultation on countercyclical capital buffers This document firstly presents a number of general remarks regarding the approach taken by the Basel Committee, and is followed by more specific comments on the concrete proposals.

EXECUTIVE SUMMARY: WSBI-ESBG welcomes the idea of addressing excessive procyclicality in the financial system. From a conceptual perspective, WSBI-ESBG agrees with the proposed framework, the main idea of which consists of linking capital requirements with economic cycles. However, we consider that the proposal is at a stage where it is not developed enough to be endorsed (especially regarding the lack of a concrete proposal on the release mechanism of countercyclical capital buffers). We also express doubts on its effectiveness. In this respect WSBI-ESBG urges the Basel Committee to take into account the specific business model of retail banks in order to avoid a risk of credit crunch. We also propose an <u>alternative approach</u> which could, in our opinion, address some of the issues that we raised in our response to the consultation.

I. GENERAL REMARKS

a) *Overall assessment of the approach taken by the Basel Committee*

WSBI-ESBG generally agrees that the issue of excessive procyclicality in the financial system needs to be addressed, yet at the same time wishes to highlight that cyclicality is inherent to banking activities. As such, the issue of excessive procyclicality has to be addressed by taking into account the specificities of the banking sector and particularly those of retail banking activities.

Referring to the Basel Committee's proposed approach in its proposal of December 2009 "strengthening the resilience of the banking sector" (BCBS 164), the main concern of WSBI-ESBG was related to the **idea of simultaneously handling a unique problem (excessive procyclicality) through various angles:** the introduction of forward looking provisioning, the introduction of a leverage ratio and the introduction of countercyclical capital buffers. Our remarks still hold today: it is in our view necessary to limit the number of ways in which to address the issue of excessive procyclicality and to only introduce targeted changes, after a carefully conducted impact assessment. It is also of particular importance for the accounting and regulatory communities to work together in order to reach solutions, which are appropriate from both perspectives.

Overall, WSBI-ESBG lists four main reasons why the Basel Committee should pay particular attention to the effects of all the proposed changes on banks' capital requirements:

- Complexity: First of all, the Basel Committee should ensure that the sum of all the measures will not excessively increase the complexity of the framework applicable to banks. We stress that the Basel Committee should limit the number of proposals to address excessive procyclicality to one or two proposal(s) maximum after carefully assessing their impact.
- Excessive capital: Additionally, the Basel Committee should also ensure that the sum of all the measures will not result in banks holding capital buffers beyond what is necessary to maintain a resilient banking sector. Conducting an in-depth calibration exercise is of the utmost importance.
- Banks versus other financial institutions: WSBI-ESBG highlights that the proposals could hamper banks with respect to all other financial companies. In order to avoid competitive distortions, the Basel Committee has to follow a more flexible approach, such as, for instance, when it comes to controlling the latitude banks can have in order to distribute their earnings.
- Retail banks versus other banks: Finally, the specific business model of retail banks has also to be taken into account in order to avoid the risk of a credit crunch. The proposal could excessively increase the cost of funding of banks in normal times, which would incentivize them to limit their credit allocation. History has proven that increasing capital requirements encourages banks to develop activities that demand less capital. Overall it is possible that increasing capital requirements will reduce banking intermediation in Europe. Paradoxically, the proposal could ultimately favour an originate-to-distribute model financial system (disintermediation and securitisation) rather than the classical buy-and-hold business model. It is therefore important to take into account the specificities of the different business models of banks. Each jurisdiction should be aware that different business models may require different levels of capital buffers.
- Specificity of some economies :The proposed methodology disadvantages economic convergence of emerging markets (especially in Central and Eastern Europe) due to higher volatility in both parameters (credit and GDP) used in the model. The growth of emerging economies depends heavily on credit growth. Implementing a strict Credit-to-GDP-ratio as a buffer trigger would in fact make it very difficult for emerging markets to develop. Banking groups operating in emerging markets could suffer from a competitive disadvantage if the Basel Committee does not to analyse the specificity of the emerging markets.

b) Concern about the pace, coherence and volume of regulatory change

The financial crisis has highlighted the urgent adaptation of the regulatory framework of banks. However, we are concerned that the **speed** by which the new measures are devised and adopted occurs at the expense of the quality of regulatory output. Too often during the past two years, regulatory proposals were not accompanied by serious studies as to their suitability, justification, impacts and cost-benefit analysis. Consultation processes, if any, were reduced to minimum periods, and stakeholders have been overwhelmed with questions from various sources. For instance the present consultation opened during the holidays lasted less than two months.

In addition we regret that we do not easily understand the coherence behind the timeframe of the consultations. We had understood that countercyclical buffers consultation would be integrated the

one for capital conservation buffers. However, the present consultation focuses on countercyclical capital buffers and leaves aside the latter, an issue which was raised by various stakeholders.

All this is regrettable; as it ignores that the main purpose is not to have some new rules in place, but to have better rules that address real problems.

There is also a real risk of moving to **over-regulation**. This involves enormous costs and burdens, not only for financial institutions but also for the economy as a whole, risking to significantly misallocate resources. Such misallocation of resources will have a negative impact on the real economy. This large amount of regulatory reform paradoxically places a **heavier burden on the retail banking sector**, which was the most resilient during the crisis.

c) Impact assessment and calibration

As already indicated above, conducting an overall cumulative impact assessment is crucial. WSBI-ESBG is confident that regulators will analyse the results of the ongoing Quantitative Impact Study (QIS) very seriously, and appropriately calibrate the proposed measures.

Appropriate calibration is key to the success of the proposed regulatory reforms. It can be done only on the basis of the results of a trustworthy impact study. Calibration is critical for getting the new rules right and making them capable of addressing current failures; if the new rules are not properly drafted they have the potential to result in a massive negative impact; not only on banks but also on all other economic sectors.

II. Specific comments on the proposals contained in Consultative Documents (BCBS 172)

From a conceptual perspective, WSBI-ESBG agrees with the proposed framework, the main idea of which consists of linking capital requirements with economic cycles. The countercyclical capital buffer proposal would work by giving each jurisdiction the ability to use their judgment to extend the size of the minimum buffer range established by the capital conservation buffer. This will be performed by implementing a buffer add-on during periods of excess aggregate credit growth.

The Basel Committee stresses that the proposal has a single objective which is to achieve the macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build up of system-wide risk. The aim of this measure is to ensure that the bank has the capital on hand to help maintain the flow of credit in the economy without its solvency being questioned, when the broader financial system experiences stress after a period of excessive credit growth.

As already stated in our response to the consultation of December 2009 “strengthening the resilience of the banking sector” (BCBS 164) WSBI-ESBG considers that the idea of protecting the banking sector from excess credit growth is in itself interesting. However, WSBI-ESBG has a number of concerns and urges the Basel Committee to be very cautious.
We recall our assessment of the BIS very preliminary views, when we already wondered if it is possible or even desirable to measure the macro-level risks across banking sector activities. Regarding the present consultation, we understand that these additional buffers aim at aligning the behaviour of the whole banking industry with the concerns of supervisory and prudential authorities. This raises numerous questions and all of them do not seem to be addressed as the banking industry is a risk taking business by definition as cyclicality is inherent to its activities. Furthermore, the consultation paper approaches procyclicality from a top-down perspective, not taking into account the structure of portfolios and their one by one risk assessment. It does not make any difference between institutions, business models and specific segments. Such a policy could be redundant for the retail banks whose business model consists in building capital buffers. Lastly; and as the Basel Committee acknowledges, calibration which is foreseen only by the end of 2010, will be a key aspect of the proposals.

Against this background, and while we support the idea to link capital requirements with economic cycles, we are sceptical that at this stage of the proposal, capital conservation buffers could cancel out the propensity banks have, when facing an economic crisis, to decrease their exposures and fire-sell their assets in order to maintain an adequate capital ratio. Notwithstanding this issue of calibration, we consider that the consultation paper needs important clarification to be operational. Therefore **WSBI-ESBG proposes an alternative approach which would appear in our view not only more practical but also more effective.**

We have divided our concerns into three sections: **fundamental concerns, operational concerns and proposal for an alternative approach.** We will also reiterate our position on **capital conservation buffers**.

a) Fundamental concerns with the proposal on countercyclical capital buffers

1. The issue of the release mechanism and possible contradiction between market expectations in time of crisis and the aim of the proposal.

As crises are rare, the introduction of capital buffers will impose significant capital constraints on an every day basis for banks. An inappropriate level of regulatory requirements (i.e. too low or too high capital buffers) might prove to be either inefficient or excessively expensive.

Because capital is costly and because investors in times of crisis are looking for secure investments, we believe that there is a risk that the proposed buffers would turn into a set of new minimum requirements thereby missing the initial objective. **We remain highly sceptical of the fact that banks would be allowed, by the market, the rating agencies or even their supervisors, to actually use their buffer when the economic situation deteriorates.** We recall the recent experience in the latest crisis when market expectations (and also regulators' demands at that time) forbid banks to reduce their capital base. On the contrary, they had to boost it immediately. This is precisely at the time that banks will be expected to hold more capital to withstand the economic or financial crisis. Based on experience, we wonder if the fact that capital markets generally expect higher capital requirements in time of crisis renders the BIS approach on capital buffers ineffective.

Therefore, from an economical point of view buffers will be very difficult to release and will inevitably become another layer of capital requirement above the minimum capital requirement set by the regulators. Vis-a-vis the market, banks cannot afford to show a level of capital ratios that could put constraints on earnings distribution. Reaching such a level would weight on their market capitalisation and aggravate their situation in terms of their ability to raise capital. That is why banks will integrate the conservation capital buffer add-on as a new minimum in their capital planning. This also why we are opposed to a measure that would explicitly put constraints on management's and **shareholders' rights** in respect of earnings distribution. It contradicts basic rights of shareholders in our legal framework and would also put some banks in a difficult situation when competing to raise capital.

In addition, we consider that even if capital markets changed their attitude (which is highly unlikely) the fact that **there is no credible explanation on how the release mechanism of buffers would work, is a major issue.** The consequence is that, even if markets operate differently, the capital buffer will very likely translate into a new layer of minimum capital requirements even though this is not the original intention of the regulators. In other words, as there is no clear guidance as to when the buffer may be used and as the consultation while it states that add-ons expressed as a percentage of RWA will be applied rarely (every 10 to 20 years) **we believe that the lack of credible release mechanism for countercyclical capital buffers will turn them into permanent add-ons.** Such a release mechanism should not be rule-based and should on the contrary allow flexibility and adaptability.

We doubt that the capital buffer mechanism can provide the required flexibility in prudent capital management it is meant to foster.

2. The necessity to distinguish between the objective of countercyclical buffers with monetary policy

By putting some constraints on lending the proposal can help to correct the effect of an over-heating of the economy. The aim is to avoid that excess of credit growth fuels economic bubbles. However, such a responsibility is already taken by monetary policy makers whose role is, amongst others, to avoid the building up of bubbles in the first place. Therefore, WSBI-ESBG considers that the objective of the countercyclical buffer needs clarification as it appears to mix up economic and monetary policy objectives with prudential supervision.

In addition, we wonder if the proposal addresses conveniently all the issues of procyclicality. Firstly there is a timing issue: if there is a slow-down of measured GDP growth as compared to credit growth this may trigger the buffer which would then increase the cost of lending and, in turn, therefore may negatively affect GDP growth and increase procyclicality. Secondly and as previously lined out, it is not clear in how far the buffer could address procyclicality during a recession: i.e. whether releasing the buffer can effectively counteract the "procyclically excessive" reduction in bank lending arising during an economic downturn. Implementing a buffer add-on, while taking into account a single criterion, i.e. excess aggregate credit growth, would not necessarily encompass all the complexities of economy.

The effect of the measure as currently proposed could be largely ineffective. Indeed, and as opposed to other monetary policy tools such as interest rates, which apply to all actors and focus on new lending, the measure will apply only to regulated institutions. **For the measure to be effective it should seek to curb all new lending, including the portion extended by non regulated entities**.

Furthermore, bearing in mind the amount of time needed to detect and measure excessive credit growth, to take the decision to impose a buffer in coordination with the various regulators and to leave banks an incompressible time to adjust, one might also question whether the implementation can be swift enough to be effective from a macro economic standpoint compared to other economic and monetary policies which are already available.

3. Concern on the preservation of a level playing field between banks and other financial companies

In this context we wish once more to emphasise the importance of a level playing field amongst institutions that grant loans. The recent crisis has clearly demonstrated that the unregulated sector played an important role in fuelling excessive credit growth.

While we generally challenge the capacity of buffers to reduce procyclicality and improve the stress resilience of banks, the introduction of capital buffers on top of a minimum capital requirement and the corresponding control of dividend payments could from our point of view hamper the competitiveness of retail banks with all other financial companies.

First of all, **capital buffers will intensify the pressure on banks because they have to attract investors to raise capital to comply with the increased capital requirements**. Regulators should bear in mind that banks have to compete not only among the group of financial institutions but with all participants on the global capital markets in respect to raising fresh capital.

Secondly **banks should be granted sufficient latitude to distribute their earnings in order to attract investors and avoid facing competitive distortions**. Therefore, we have serious concerns over additional regulatory rules which restrict paying dividends to shareholders and investors. This proposal, on top of a higher minimum capital requirement, would limit the attractiveness of banking shares vis-à-vis other industries.

This worldwide competition to raise capital is also a reason why shares with preferential distributions rights should still be considered as equity and part of Predominant Core Tier 1 capital. Features that differentiate common shares from regular voting common shares are needed to compensate investors for missing voting rights or for convincing new investors to recapitalize a bank during stress situations. There is no difference in quality between common shares and preference shares when it comes to absorb losses (preference shares are subordinated to all other debt instruments). On the contrary, preference shares will be needed, first of all, to maintain the competitiveness of banks vis-à-vis other financial institutions and, more importantly, to ensure that banks will be able to raise the necessary amount of capital when they will all face a systemic crisis.

Finally, there is the general concern that the proposal might trigger competitive distortion as Basel III might not have the same impact in different parts of the world. Some banks might appear artificially highly capitalized while in reality a significant part of the risk lies in an unregulated sector of financial system.

4. <u>Concern on the preservation of a level playing field between banks</u>

In order to guarantee a level playing field, regulators should seek to ensure that all entities that extend or distribute credit be subject to the same constrain. Contrary to that objective, the proposed measure will lead to undesirable arbitrage between regulated financial institutions subject to the add-on on the one hand and unregulated actors able to distribute credit with no constraints on the other hand. It will give an advantage to banks operating in countries where financing is largely “disintermediated” and in the end may further encourage the transfer of lending to non-regulated entities.

WSBI-ESBG also stresses that it is of utmost importance to take into account the specificities of the different business models of banks and accept that different models will require different capital buffers. Indeed, the business model of retail banks already consists of building capital buffers. Countercyclical buffers could ultimately appear redundant with such business models in cases of inadequate calibration. The calibration and impact assessment should therefore at least make the difference between the different systemic risks that retail banks entail when compared to investment banks. It should not be forgotten that retail banks are liquidity providers to the economy and that they are not at the origin of the financial crisis.

Adopting an inadequate calibration would per se penalize retail banks and by extension an important part of the world’s economy. It would achieve the contrary to what is intended: it would not automatically address the credit crunch issue while penalizing part of the industry which did not cause the financial crisis. **In case of inadequate calibration** the growth of the demand for credit could exceed the speed at which some banks can rebuild their capital buffers. **Time inconsistency could then be a major problem**. This issue is particularly crucial as we consider that regulatory capital tends to overestimate economic capital when it comes to retail activity. Numerous empirical experiences show that the internal rating parameters used in assessing the risk of retail portfolios (and especially when taking into account the correlation between different assets) leads to lower economic capital than the regulatory requirements of Basel II

Against this background **we deplore that the measure should apply equally to all banks, thus failing to differentiate between banks that adopt an aggressive lending policy and those that stick to conservative lending criteria.** For example, there may be instances where an internationally diversified bank with a low market share in a particular country may choose to resort to aggressive lending to win local market share, thereby fuelling excessive credit growth in that particular country. The countercyclical buffer would then result on all local banks being unduly penalized regardless of the soundness of their credit strategy and policy. In this example, local banks

significant market shares will also find it more difficult to adapt before the countercyclical buffer comes into force compared to the bank(s) responsible for credit growth.

5. Concern on funding for SMEs

A particular concern relates to the availability of funding for SMEs. While credit allocation to SMEs is individually risky, diversification, along with an in-depth client relationship mitigate it to a great extent. This is the reason why retail banks' economic capital, when measured with internal models, is generally inferior to the capital measured by regulatory formulas. Such a gap should not be increased.

Not only did the crisis clearly make banks more risk adverse, rather banks also have a natural tendency to increase their credit rates in periods of economical stress. Any extension of the difference between regulatory capital and economic capital could heighten the credit limitations that SMEs face when it comes to their short-term and treasury issues. **It is therefore essential to calibrate the proposed measures by taking into account the specificities of the business model of retail banks.** Capital buffers that are too high will affect the lending activity and dramatically increase the prices of the loans. It is therefore possible that countercyclical buffers ultimately appear redundant with the business model of retail banks if they do not take into account the specificity of their business models. This would appear counterproductive as retail banks' business models have proven to be extremely resilient during the crisis.

6. The necessity to clarify the interaction between the capital buffer mechanism with Pillar 1 and Pillar 2

The countercyclical capital buffer mechanism would neither be a Pillar 2 nor a Pillar 1 approach. WSBI-ESBG is not at ease with such a proposal. First of all, the consultation says that the Pillar 2 approach will need to adapt to accommodate this new instrument but the Basel Committee provides little guidance as to how this accommodation would be done. We are also concerned by the statement made that the capital used to meet Pillar 2 requirements should not be used to satisfy the countercyclical capital buffer requirement. **We fear this may lead to double counting of capital as stress-testing in Pillar 2 already leads to defining capital buffers**.

One way to avoid the collusion between Pillar 1 and Pillar 2 could be by covering them with capital stress-testing carried out under Pillar 2. We will present in the third part of our comments this alternative approach.

b) Concerns on operational difficulties

The proposal raises also some concern as it entails a number of operational difficulties and complexities such as:

1. We regret that the BSBC paper provides **no real guidance in respect of criteria to be used for releasing the countercyclical buffer** although it will be a particularly critical decision to take. Such guidance would be useful so as to diminish the **moral hazard** that would, without any doubt, arise from banking supervisors who will have to work in cooperation.
2. We fear the **modus operandi of the countercyclical buffer will turn out to be excessively complex,** particularly in terms of home/host arrangements. In case of disagreement or inconsistencies, this leaves the door open to **national discretions** as for instance the home supervisor can choose to impose a higher buffer than the one calibrated by the host supervisor. This could trigger tremendous political issues as some kind of hidden government industrial strategy could be intended or suspected.
3. The **host authorities will have the right to demand** that the countercyclical buffer be held at the level of entities located in their jurisdiction. It remains unclear as to how this will function where credit exposure to entities located in this jurisdiction is booked in another country. This raises numerous issues on how the cooperation between the different supervisory authorities will be performed. **We think that the level playing field is compromised with the current proposal which fails to provide clear guidance on how different supervisors should cooperate**.
4. **The criteria retained to determine the country location of an exposure may lead to inconsistencies or arbitrage**, particularly if this is based on the nationality of the borrower. For instance, lending to large corporates could be redirected to a borrowing entity located in a country with no or a lower countercyclical buffer, irrespective of the actual location where the financing will be used by the borrower.
5. **Data availability** is also a major issue. Some information would be extremely burdensome to retrieve or even not available at all (especially regarding the calculation of the credit to GDP ratio on the long term). In addition we inform the Basel Committee that in case of structured products the workload might be tremendous. Therefore we suggest a threshold under which data would not be required so as to diminish the burden on banks.
6. The **cost and burden** related to the practical implementation of the countercyclical requirements related to **exposures in different countries** has to be taken into account. Global corporates have often exposures in many countries, and the effect of variable buffers is unclear. We suggest that a countercyclical requirement should be placed on exposures where the effects easily can be identified.
7. WSBI-ESBG has a major concern regarding calibration. The Basel Committee itself acknowledges that the **calibration of the additional countercyclical buffer** (in terms of sizing the buffer required based on macroeconomic variables) will remain a difficult exercise **requiring a lot of judgment on the part of the regulators**.

8. **The one-year advance notice period for the countercyclical buffer** may not be manageable from a capital planning perspective: it will lead banks in a large number of countries to reinforce their capital structure for potentially significant amounts at the same time.
9. **The credit/GDP ratio should be considered with flexibility**. Indeed it should not be considered to all markets especially to markets in Central and Eastern Europe in the same way as it would in Western Europe. In such country the ratio will be different from the ratio of Western countries and therefore it is possible that groups operating in both markets will face difficulties.
10. **Finally, the methodology itself introduces some arbitrary elements** in the relationship between credit and GDP. It implies that as time goes on more credit is needed per unit produced. However, this relationship seems to be governed by a deterministic trend. An "ad-hoc" filter is applied as the Hodrick-Prescott filter, with which the "trend" is built up. We understand that the choice of the value of the parameters of this filter or the application of another type of filter could lead to a different trend. This means that, in practice, each supervisor will determine their own path of credit growth target and adjust the add-on in accordance with the deviations from this objective. In summary, we believe that the proposal tries to introduce a general discipline of a higher demand for equity in situations of excessive credit growth, as a potential future systemic risk, leaving a fairly wide margin of discretion to national supervisors.

c) Alternative approach

WSBI-ESBG believes that the issue of procyclicality concerns some actors more than others. Indeed retail banks will not have the same propensity to increase the credit with outstanding dimensions. However the proposal does not seem to take into account this important specificity. While there are many details of the countercyclical approach that are not yet finished, it seems that the Committee maintains its "buffer-on-a buffer approach" what would be applied to all banks.

We are uneasy regarding a proposal that wants to apply a single formula to all banks and adjust the result with the judgment of supervisors. We are also concerned that the countercyclical buffers would not be included neither in Pillar 1 nor in Pillar 2. Finally we would have liked more consistency as to where the countercyclical buffers would be held: host authorities have the right to demand that the countercyclical capital buffer be held at the individual legal entity level or consolidated level within their jurisdiction.

This is the reason why **WSBI-ESBG proposes an alternative approach** which is to require additional capital buffers based on different standardised stress test scenarios and to require capital based on this instead of using the proposed macro indicator. Supervisors should review stress testing outputs in order to assess if the test performed by the institution were appropriate to its risk profile and if the mitigating actions were in line with the results. The results of the **stress test** should be taken into consideration in the decision making process of the financial institution and the actions should be credible. Supervisors could consider recommending scenarios to institutions and undertaking their own stress tests on an individual institution. Each supervisor would adapt these guidelines to their country specificities and this should be very clear to maintain a level playing field. Those stress testing could supplement a series of statistical pre-determinated formulas with the judgement of experienced local supervisors. The specific concerns about the build up of credit

excessive growth and bubbles could be handled in the form of specific guidance as to the additional scenarios to be included in capital stress-testing, instead of a separate, standalone capital buffer.

In addition, our view is **that all necessary buffers could be covered by the capital stress testing carried out under Pillar 2,** resulting in a single institution specific buffer that includes all the risk factors and business model/mix of the institution. Such a position is consistent with our statements above regarding the general response of markets to financial crisis, capital buffers should not need to be disclosed to the market. If they were disclosed, the market could treat them as additional capital requirements to Pillar 1, losing the countercyclical effect. The principle of proportionality should also be applied in this case and stress testing programmes should be included in the **Pillar 2** assessment of the institutions, considering severe scenarios and covering all risks and portfolios that are material for the institution (market, securitisation, credit and counterparty, liquidity, interest rate risk in banking book, operational and concentration…).

Finally, those risks should be calculated at a consolidated level (so as to avoid any issue regarding the minority regime and the capital available within banking groups as well as to simplify the work of banks **while** limiting the difficulties between home-host supervisors).

For all these reasons WSBI-ESBG is sceptical on this proposal. Even though we are fully aware that a judgemental approach is important to strengthening micro-supervision **we suggests that the Basel Committee does not implement what appears to be a rules-based regime**. We believe that this is an indirect and insufficient response to the problem of procyclicality of capital. There is too much uncertainty as to how the tool would work. More analysis must be made and further documentation of impact has to be performed.

Alternatively, in order to better preserve its countercyclical purpose capital buffers, such buffers should be treated under Pillar 2 and so as to avoid a de facto increase of minimum capital requirement.

d) Comments on capital conservation buffers.

The Basel Committee proposal on Capital conservation buffers does not seem to have been changed by the present proposal. Such a capital conservation buffer would be a uniform and fixed capital buffer across banks, will raise important concerns, depending on national circumstances. Given its inflexible nature, the proposed fixed buffer would likely be perceived by sound banks and by the market as a practical increase in minimum required capital, quite apart from the countercyclical-capital proposal. **WSBI-ESBG is of the view that the conservation buffer should be disregarded or at least be considered be variable and flexible**, allowing the local authority discretion over how to achieve soundness and stability of banking sectors consistently with international goals but reflecting differences in operating environment.

Alternatively, the Committee could set a specific buffer zone for a specific capital ratio that would trigger a supervisory review as to whether capital needs to be conserved and, if so, by how much. The replacement of the specific regulatory buffer with a bank-by-bank specific buffer (established in Pillar 2), would allow the supervisory to be more strict to a specific financial institution without being disclosed to the market. Regarding the frequency of calculation if the supervisors decide to include the conservative buffer, it would be more appropriate to set the schedule for an annual calculation (December) to be consistent with the distribution of results (which usually have annual distribution though some entities distribute interim dividends).

As already stated we have serious concerns with additional regulatory rules which restrict paying dividends to shareholders and investors. This proposal, on top of a higher minimum capital requirement, would limit the attractiveness of banking shares vis-à-vis other industries. Likewise, capital buffers will intensify the pressure on banks because they have to attract investors to raise capital to comply with the increased capital requirements. Regulators should bear in mind that banks have to compete not only among the group of financial institutions but with all participants on the global capital markets in respect to raising fresh capital.

As highlighted above there is a very real concern about double-or triple-counting of capital requirements. It is obvious that this unnecessary multiplication of capital burdens would be damaging due to the close link between GDP and credit, which is the basis of the current proposal.

About WSBI-ESBG (World Savings Banks Institute – European Savings Banks Group)

WSBI-ESBG – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 90 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESBG, the European Savings Banks Group). WSBI works closely with international financial institutions and donor agencies and facilitates the provision of access to financial sectors worldwide – be it in developing or developed regions. At the start of 2009, assets of member banks amounted to almost € 9,000 billion, non-bank loans to € 4,300 billion and non-bank deposits to 4,600 billion. Together the member banks conducted operations through 160,000 outlets.

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of over € 6.000 billion, non-bank deposits of € 3.100 billion and non-bank loans of € 3.300 billion (all figures on 1 January 2009). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI and ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI and ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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