ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

September 14, 2010

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

Re: Response to BCBS consultation on countercyclical capital buffers

Dear Sirs,

The Standing Committee on Financial Stability of the International Council of Securities Associations (ICSA)[1] is pleased to respond to the BCBS consultation on countercyclical capital buffers.

Standing Committee members strongly support measures to reduce excessive procyclicality in financial regulation, including in the Basel Accords. Nonetheless we have some very specific objections to the proposal for countercyclical capital buffers, which are developed below.[2] In particular, Standing Committee members consider that it is too early to be able to determine the extent to which countercyclical buffers are necessary, or if they are necessary at all, given the fairly recent implementation of Basel II and the significant revisions being developed for Basel III. Moreover, it is not clear that the proposed capital buffers offer any real advantage over the instruments that regulators already have access to in order to reduce excessive credit growth. Standing Committee members are also concerned that the imposition of the proposed capital buffers could have unintended consequences, and may actually increase rather than dampen systemic risk.

[1] ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA and a list of ICSA members is available at: www.icsa.bz

[2] AFME, a member of ICSA's Standing Committee on Financial Stability, has abstained from this response as it has submitted a separate response (through GFMA).

In light of these concerns, we believe that it would be important for the Committee to undertake additional analysis, market assessment and consultation with stakeholders prior to implementation of the proposed countercyclical capital buffers.

1. Countercyclical buffers may not be necessary

In the wake of the recent financial crisis, the political imperative to develop new regulations and procedures that will address procyclicality is quite understandable. Standing Committee members are concerned, however, that it is not possible to adequately assess the degree of cyclicality of the new Basel requirements, since the Basel framework is undergoing such a profound revision. In light of the changes taking place in the Basel accord, we think that it is difficult to determine if countercyclical buffers are even needed. Once the Pillar 1 requirements are determined, it should be possible to arrive at a better assessment of the extent to which the procyclicality of the Basel Accord has been addressed. Until then, it is not possible to assess the extent to which countercyclical capital buffers would be necessary or even minimally useful

Moreover, while the consultation document points to the potential countercyclical capital buffers as an important instrument for macroprudential policy, regulators and policy makers already have access to a large number of instruments that can be used to dampen excess credit growth. These include reserve requirements, minimum loan-to-value requirements, loan servicing requirements, margin requirements, and possibly variable risk weights. Since these and other already existing measures can and have been used to reduce credit growth in various jurisdictions at various times, it is not clear that the proposed countercyclical capital buffers are actually necessary.

2. Countercyclical buffers may have unintended consequences

Globally, regulators have extremely limited experience with implementing and managing countercyclical capital buffers. Therefore, most regulators/national authorities will be learning how to operate a new policy tool at the same time that the other aspects of the new Basel framework will also need to be implemented. As a consequence, there will be a great deal of uncertainty about how the capital buffers will be applied in different jurisdictions.[3]

Moreover, as the consultation document notes, national authorities are expected to apply a considerable amount of judgment in setting the level for the buffers in their own jurisdictions. This is a potentially problematic aspect of the proposal, as authorities in

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[3] Even the authors of the recent BIS research paper on countercyclical capital buffers noted that, "…the conclusions of this paper should be seen as providing some initial suggestions rather than the final answer as to how countercyclical capital requirements should be implemented." See Mathias Drehmann, Claudio Borio, Leonardo Gambacorta, Gabriel Jiménez, Carlos Trucharte. *Countercyclical capital buffers: exploring options*. BIS Working Papers, No. 317 (July 2010).

one jurisdiction may not adequately know about or understand the build-up of systemic risk in other jurisdictions with which they are linked, economically and or through financial markets. In addition, the variable indicator used to assess the build-up of systemic risk needs to be reliable, useable and comparable for the range of jurisdictions being covered. In this regard the suggested credit-to-GDP ratio may not necessarily provide a timely and reliable lead indicator for financial distress in emerging market economies.

Moreover, because judgment will be needed in setting the required level for the countercyclical buffers, it is quite possible that the level of countercyclical capital buffers will differ substantially between jurisdictions. This in turn could encourage capital movement between jurisdictions, with capital flowing to those jurisdictions with lower levels of capital buffers. As a result, rather than leading to a general reduction in credit growth on a global basis, it is possible that the countercyclical capital buffers could encourage the build up of systemic risk in those jurisdictions with lower or minimal countercyclical capital buffers.

The imposition of countercyclical capital buffers could also encourage disintermediation away from the prudentially regulated banking sector into the non-prudentially regulated sector of the capital market. That is, rather than dampening overall credit growth in a given jurisdiction, the imposition of countercyclical capital buffers could have the effect of encouraging the growth of the non-bank sector at the expense of the banking sector.

There is also concern that the countercyclical capital buffer would be applied equally to all banks, thus failing to differentiate between banks that adopt an aggressive lending policy and those that stick to conservative lending criteria. In the event that national authorities determine that credit growth has been excessive, the countercyclical buffer would be imposed on all banks. Those banks that had followed a more conservative lending policy would be unduly penalized regardless of the soundness of their credit policy.

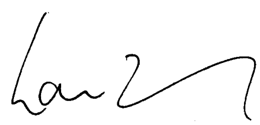
Finally, there is serious concern that the new countercyclical capital buffer will be perceived as a new minimum capital requirement, which in turn could have a negative impact on market sentiment and on banks' lending capacity. This would be particularly important during period of stress, when under the proposal banks should be allowed to reduce their countercyclical capital buffers. In actual fact, however, past experience suggests that banks will be penalized if they allow capital ratios, once built up, to fall back in times of stress. Consequently, further consideration needs to be given to developing counter-balancing adjustments that would offset the impact of rating migration on risk weighted assets.

Given the issues raised in this letter, we urge the Committee to carefully weigh the possible impact of the proposed countercyclical capital buffers. It is important to further test the proposed approach taking into account all of the other changes that are being implemented in capital and liquidity requirements, as these may have already substantially reduced the excessive procyclicality of the Basel framework.

Over the longer term, given sufficient testing of the proposal and dialogue with the private sector, it is possible that countercyclical capital buffers may become an important macroprudential tool for regulators and policy makers. However, given the large number of difficulties with the current proposal, only some of which are discussed here, we urge the Committee to take additional time so that it can examine the issue more completely and more carefully.

Once again, we appreciate the opportunity to comment on the Basel Committee's proposal for countercyclical capital buffers. We look forward to our continued work with the Basel Committee in strengthening the resiliency of the global economy.

With very best regards,



Pierre de Lauzun, Chairman
ICSA Standing Committee on
Financial Stability and Risk Management