Ministry of Finance
of the Czech Republic

23 November 2010

The Ministry of Finance of the Czech Republic response to the European Commission internal market and services' Consultation Document on Countercyclical Capital Buffer

We would like to thank for the opportunity to comment the document providing the preliminary views of the Commission services on the countercyclical capital buffer. Our answers to the questions are as follows:

Question 1:

We believe that the countercyclical capital buffer should be able to accumulate (during the economic boom) and release (during periods of the economic decline) capital in line with the fluctuations in the economic cycle. However, the fixed amount of capital buffer will likely determine its efficiency, i.e. reducing the procyclicality of the financial system. It is vital to consider the importance of ongoing rigorous calibration of the capital buffer in order to maintain the effectiveness of this instrument.

After careful consideration of all methods we prefer the method proposed by the Basel Committee, i.e. the method in the 12th paragraph. We believe that the concept of the countercyclical capital buffer should take into account the geographic location of exposure, as it is in our view, the way how appropriately cover the risk exposures. Nevertheless, we would like to mention the following. The method implies that in case of cross-border credits the capital buffer will be determined based on the decision of the host authorities if the creditor is located in the host country. Could not it be also considered whether the fact might/should not influence the calculation of the credit-to-GDP ratio? In other words, the given credit contributes to the credit growth (it might be an excessive one according to the home authority) in the home country, however, the capital buffer will be calculated based on a credit growth in the host country the credit growth in which will require no countercyclical buffer. Of course it is also valid vice versa.

In order to maintain the long-term stability of the banking and financial system in the Czech Republic, it is necessary to set clear cooperative rules between the home and host regulators regarding the branches of foreign banks. In this context, we believe, for instance, that the host supervisor should be continuously informed about the level of the capital buffer held on the risk expositions located in the host country.

Question 2:

We reckon that the level playing field between the internationally active and purely national banks should be achieved applying the approach set out in paragraphs 12 to 20. However, it is unlikely to exclude the opportunity of regulatory arbitrage if method B is applied. We believe that the scope for regulatory arbitrage is minimized in case of the approach proposed by the Basel Committee which reflects the primary objective of profit on investment opportunities.

Question 3:

We believe that the requirements for the countercyclical capital buffer should be applied on solo, sub-consolidated and consolidated level. For instance, the structure of the banking sector in the Czech Republic is mainly dominated by subsidiaries of foreign banking groups; therefore it is important for us that the capital buffers are held at the solo level.

Question 4:

We believe that setting a maximum amount of the countercyclical capital buffer can be a limiting factor that can influence the efficiency of this instrument because setting an upper limit may not match the growth of credit risk in the particular jurisdiction. We propose considering no limitation of the countercyclical capital buffer, i.e. implementing the buffer without a maximum upper limit or setting a limit that can be increased by the competent authorities under exceptional circumstances.

Question 5- 6:

Market transparency is essential for ensuring the functional, healthy and stable market. Therefore, we believe that it is desirable that in order to maintain the transparency of the market, the market participants should be informed about the decisions to introduce countercyclical capital buffers or about its increase.

We support that the EBA and ESRB play a key role in the development of principles and technical standards to ensure consistency in decision-making by creating an obligation for the capital buffer in each MS.

The ESRB is an institution that focuses on a surveillance of macroeconomic developments and is equipped with the required professional expertise. For this reason, we believe that this institution is the competent body to assess the risk and issue the necessary recommendations to the home supervisors to undergo the needed steps to ensure the financial system stability.

We consider that it is very important to introduce a harmonized approach of supervisors across EU. The EBA in this respect can play an important role to ensure the consistent application of capital buffer and resolve potential disputes across MS.

Question 7:

We assume that the countercyclical capital buffer should consist of Tier 1 capital. The primary source of capital for creation of this buffer should be profits or distributable retained profits/reserves. We deem as inappropriate to require banks to raise new capital by a share issuance due to a potential negative reaction that the market can have to this issue, which can in turn have a detrimental impact on the stability of the bank alone or of the financial system itself. Nevertheless, in the case that the financial institutions that would not be able to generate high enough profits in order to create required capital buffer, then the share issuance would be necessary to meet the set capital buffer obligations.

Question 8:

We assume that the conservation capital buffer is based on the risk-weighted assets and therefore we believe that it is necessary to apply the same in the case of the countercyclical capital buffer.

Question 9:

Inadequate coverage of risk exposures by banks has proved to be a serious problem in times of the financial crisis. This deficiency had a negative impact on the stability of the international financial system. In order to prevent that situation from recurring in the future, we believe that it is appropriate that the countercyclical capital buffer applies to any exposure.

Question 10:

We assume that the investment firms can be excluded from the requirements of countercyclical capital buffer, as we feel that these institutions do not contribute to the credit expansion.