Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

FAQ - Countercyclical Capital Buffers and Other Systemically Important Institutions Buffers

1. What are countercyclical capital buffers (CCBs)?

The CCB is a macro-prudential tool introduced under the European Union (Capital Requirements) Regulations 2014 (S.I. 158 of 2014).[1] It is a time-varying capital requirement for banks (and investment firms) which aims to protect the banking sector from potential losses that can arise when excessive credit growth is associated with a build-up of systemic risk. Each institution's specific CCB requirement consists of the weighted average of the CCB rates that apply in the jurisdictions where that institution has relevant credit exposures.

Essentially the CCB means that banks need to hold additional capital when there is strong credit growth in the economy. The CCB can then be released, partially or fully, either in the case of a crisis or when credit growth and associated risks recede.

As outlined by the Bank for International Settlements "*The countercyclical capital buffer aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its primary objective is to use a buffer of capital to achieve the broader 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. Due to its countercyclical nature, the countercyclical capital buffer regime may also help to lean against the build-up phase of the credit cycle in the first place. In downturns, the regime should help to reduce the risk that the supply of credit will be constrained by regulatory capital requirements that could undermine the performance of the real economy and result in additional credit losses in the banking system.*"

2. What CCB rate is being introduced?

Under Regulation 125 of S.I. 158 of 2014, the Central Bank is the designated national authority for the purposes of setting CCB rates for the State. The CCB rate for the State will be set at 0% for Quarter 1 of 2016 and will be reviewed on a quarterly basis.

[1] S.I. 158 of 2014 transposed Directive 2013/36/EU ('CRD IV') in Ireland.

3. Why did the Central Bank decide on a rate of 0%?

In setting the rate at 0%, the Central Bank took into account the following:

- Credit developments in the economy remain subdued as the non-financial private sector continues to deleverage.
- In the residential property sector, prices are growing at approximately 8 per cent year-on-year (in real terms). This represents a moderation relative to growth rates recorded at end-2014, however. Future house price expectations have also moderated.
- While commercial property prices continue to increase rapidly, this is driven by a combination of supply shortages and strong international investment demand. Credit developments and bank lending to the commercial property sector remain muted.
- Additional indicators relating to external imbalances, the private-sector debt burden and the strength of bank balance sheets, do not currently point to emerging imbalances or vulnerabilities.

4. What is the maximum CCB that could be applied?

Ordinarily the CCB rate will be set between 0% and 2.5%. If justified by exceptional circumstances, authorities can set the rate in excess of 2.5%.

Where the Bank sets the CCB rate above 0% for the first time or increases the rate thereafter, the higher rate will only apply for the purposes of calculating institution specific capital buffer rates following a period of notice, generally 12 months.

5. What is an institution specific capital buffer?

The Central Bank sets the CCB rate applicable to the Irish exposures of institutions. Similarly, designated authorities in other jurisdictions set the CCB rate applicable to exposures within their jurisdiction.

The buffer requirement for each institution, known as the institution specific capital buffer, is the exposure weighted average of the CCB rates that apply in the jurisdictions in which the institution has relevant credit exposures.

Under transitional arrangements, pursuant to Regulation 119 of S.I. 158 of 2014, the institution-specific countercyclical capital buffer requirement will be capped at 0.625% in 2016, 1.25% in 2017 and 1.875% in 2018.

6. What are Other Systemically Important Institutions Buffers (O-SIIs)?

The O-SII buffer aims to increase the resilience of institutions which are systemically important to the domestic economy. A higher capital requirement for these institutions acknowledges the greater impact that their failure would have on the domestic financial system and economy and aims to reduce the probability of the failure of these institutions.

7. What O-SII buffers are being introduced?

The O-SII buffer rate for AIB and Bank of Ireland will be set at 1.5% to be phased in with a rate of 0.5% from 1 July 2019, increasing in steps of 0.5% per year until it reaches 1.5% in 2021.

The list of O-SIIs and the buffer rates applied will be reviewed by the Central Bank on at least an annual basis.

8. What is the maximum O-SII buffer that could be applied?

The maximum buffer is 2%.

9. What factors were taken into account when setting the O-SII buffers?

The process for setting a buffer rate for these identified O-SIIs involved an assessment of:

1. The structure of the domestic banking system:

The structure of the domestic banking system, including size and concentration were considered, in line with the Basel Committee on Banking Supervision Framework for Dealing with Domestic Systemically Important Banks.

2. *The systemic importance of the institutions:*

The results of the identification assessment, which followed the EBA guidelines on assessment of O-SIIs[2], and an analysis of the importance of the systemic institutions in the domestic lending and deposit markets were considered.

3. A peer review of other countries:

[2] EBA/GL/2014/10 Guidelines On the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs)

In setting a buffer rate for these two institutions, the Central Bank also looked at the characteristics of European banks where an O-SII buffer has already been set and the size of these buffers.

10. Why is the Central Bank making these announcements?

Both buffers are applicable in Ireland from 2016. Given their origin in an EU Directive (CRD IV), all EU Member States must follow common processes on setting these buffers, as well as on the communication of the buffers. Under S.I. 158 of 2014, the notifications for both buffers must be published on the website of the Central Bank.

As a member of the Single Supervisory Mechanism (SSM) these measures will also be implemented in conjunction with the European Central Bank (ECB) and any assessments conducted by the Central Bank in this area will be without prejudice to any powers of the ECB under the SSM Regulations with respect to O-SII identification and/or buffer rate settings.