

# Countries Ease Bank Capital Buffers

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Original post [here](#).

Countries around the world are easing bank capital requirements to help banks absorb losses and to allow them to maintain the flow of credit during the COVID-19 crisis.

Most of these measures involve the [Basel III capital](#) standards that global regulators agreed to implement after the 2007-09 financial crisis. Thanks to Basel III and like measures, banks across the world have substantially more capital than they had heading into that crisis. However, the current crisis threatens to quickly eat into those capital cushions. Banks are already reporting substantial credit losses and growing balance sheets, as they meet existing commitments and extend new loans. Easing capital standards today is a form of macroprudential policy, because regulators' focus is on maintaining the health of the financial system as a whole.

This blog discusses options for easing capital standards:

1. Which buffer to adjust?
2. Constraints on capital distribution – Do countries enforce them when reducing their capital buffers?
3. How long will the change last?
4. Conditions for use of capital – Does the capital need to be used for a particular purpose?
5. Quality of Capital - Any change in the capital usually required to meet a buffer?
6. Changing risk weights - What kind of assets get their risk weights changed?

Which buffer to adjust?

Under Basel III, all banks must hold high-quality capital equal to 4.5% of their risk-weighted assets, plus a 2.5% capital conservation buffer (CCB). The purpose of the CCB is to encourage banks to conserve capital. When the buffer is breached, banks must limit bonuses to managers and distributions to shareholders. Before the current crisis, about a dozen countries had also imposed a countercyclical capital buffer on their banks (CCyB). The CCyB is a buffer under Basel III that countries can build during boom times and draw down during busts to absorb losses and mitigate the increase in risk-weighted assets; they may set it as high as 2.5%. In addition to the CCB and CCyB, many countries also impose additional buffers on systemically important banks.

During the current crisis, most countries that had earlier activated their CCyB have now cut it. But countries without a CCyB have found other ways to ease capital requirements. Several have told banks they can use their CCBs, resulting in automatic consequences for bonuses and dividends. Others have reduced the surcharge they had imposed on domestic systemically important banks (D-SIBs), their broader systemic risk buffers (SRBs), or other company-specific buffers.

Countercyclical capital buffer (CCyB)

To combat the COVID-19 crisis, close to 20 governments have released, reduced, or delayed planned increases in their countercyclical capital buffers. As regulators had designed it as a countercyclical tool, it is the easiest to deploy in a crisis.

Ten countries have released their entire CCyB, according to [Yale's Financial-Intervention Tracker](#). The size of the decrease determines its impact. [Sweden](#) reduced its buffer the most, from 2.5% to 0%, freeing SEK45 billion (US\$4.5 billion) in capital; that much capital could make roughly \$60 billion available for lending, or more than 10% of Sweden's GDP. Denmark and France had planned to raise their buffers, but instead cut them to zero.

Bulgaria and the Czech Republic left their buffers at zero, canceling planned increases. In the United States, the [Federal Reserve Board](#) is responsible for setting the CCyB, and has maintained it at zero since 2016. Most countries, including [18](#) in Europe, have also kept their CCyBs at zero since 2016.

### Capital Conservation Buffer (CCB)

For countries that had not raised their countercyclical capital buffers before the crisis, the capital conservation buffer (CCB) is a common alternative.

Nine authorities, including the [European Central Bank](#), have allowed banks to use their CCB in the current crisis, according to our tracker. Of these, four replaced it with a new, lower target, and five have encouraged banks to use their buffers without specifying a new target. The United Arab Emirates lowered it the most—from 2.5% to 1%. Brazil and Oman cut their buffers in half, from 2.5% to 1.25%. Sri Lanka lowered it more for large banks (to 1.5%) than for others (to 2%).

By international agreement, the CCB is 2.5% of risk-weighted assets, but countries typically allow their banks a few years to build capital to that level. India and Ukraine had been on the way to building their banks' buffers to 2.5%. With COVID-19, they have delayed further implementation. India has said it will hold its CCB at 1.88%, and Ukraine will hold its CCB at 0.63%.

### Domestic Systemically Important Bank (D-SIB) Surcharges and Systemic Risk Buffers (SRBs)

Basel III also introduced capital surcharges for systemically important banks. The purpose of these surcharges is to force banks to internalize the costs of their potential failure on the broader financial system. The Financial Stability Board, which is made up of leading national central banks and finance ministries, determines the “global systemically important banks” (G-SIBs). G-SIBs are subject to a G-SIB capital surcharge, based on international agreement. Regulators have not revised G-SIB surcharges so far in the crisis.

However, prior to this crisis, many countries had introduced capital surcharges for domestic systemically important banks—banks in their jurisdiction that didn't make the global list, but which they considered important to their own economies. During the COVID crisis, at least a half-dozen countries have lowered those surcharges. For example, [Canada](#) lowered its surcharge on D-SIBs from 2.25% to 1%.

Some countries reduced D-SIB buffers that applied to individual banks. This is the case in the [Netherlands](#), which reduced the systemic buffer of 3% for three of its five systemically important banks to 2.5% for ING, 2% for Rabobank, and 1.5% for ABN Amro. This will free up EUR 8 billion in capital to back more lending. [Hungary's](#) D-SIB buffers ranged from 0.5% to 2.0% for its largest banks before the crisis; it has cut all of those to zero.

Under Pillar 2 of the Basel capital accords, supervisors also may set company-specific capital requirements on top of those that apply to all banks. The [ECB](#), among others, has advised banks it directly supervises that they may operate temporarily below the level of capital defined by their Pillar 2 guidance.

Some countries also have a systemic risk buffer (SRB) to cover systemic risks that other aspects of the capital requirements don't cover. Poland—whose systemic risk buffer [applies](#) to all domestic banks—appears to have [eased](#) its SRB the most, from 3% to 0%. [Finland](#) reduced its systemic risk buffer to zero; it had previously set the systemic risk buffer at 1%-3%, depending on the bank. Finland also lowered its D-SIB buffer for one out of three D-SIBs.

Similarly, Australia's regulator, in 2017, had set benchmark capital targets above minimum regulatory requirements to enable banks to be regarded internationally as “unquestionably strong.” During this crisis, it [said](#) it “would not be concerned if they were not meeting the additional benchmarks announced in 2017 during the period of disruption caused by COVID-19.”

In mid-March, the [US Federal Reserve](#) and Japan's [Financial Service Agency](#) said they were encouraging banks to use their buffers, without specifying which buffers or to what extent.

### Constraints on Capital Distribution

[Basel](#) standards dictate that banks that do not maintain their CCB standard will face automatic constraints on capital distributions, that is, dividends and share buybacks. These policies are enforced when a bank's capital dips below its “expanded” CCB, which includes the CCyB and systemic risk buffers.

Many countries that eased capital buffers—including Australia, Canada, [Denmark](#), Estonia, Finland, Iceland, Norway, Sweden, and the U.K.—set an expectation that banks should halt or not increase their dividends. The [ECB](#) has suggested that banks use their additional capital to support the economy and not for capital distributions.

Russia demanded that credit institutions “comply with the set limits for the share of profits to be distributed in accordance with the buffers' size, including dividend payouts and compensations (incentives) to be paid to management.” The [Czech Republic](#) has explicitly required that banks refrain from making dividend payments or anything else that may compromise their resilience.

US regulators have not imposed a freeze on dividends or other shareholder distributions. The eight US-based G-SIBs [voluntarily suspended stock buybacks](#) in the second quarter of 2020. Fed Chair Jerome Powell [said](#) on April 9 that the Fed is watching “to see how things evolve” but does not yet think a dividend freeze is appropriate. Similarly, Japan's regulators have encouraged banks to use buffers but have also not commented on dividends.

### How Long Will the Easing Last?

Most countries have eased their buffers indefinitely, and many that have maintained or reduced their buffers have acknowledged the possibility of further decreases in capital buffer requirements. However, some have established plans for recovery and reestablishment of their capital buffers. Norway does not anticipate increasing their CCyB until at least [2022](#). [Ukraine](#) eased its CCB by no longer requiring banks to adhere to capital buffer guidelines, and plans on rebuilding it to the full 2.5% by 2023. [Malaysia](#) said it “fully expects” banks to restore their buffers “within a reasonable period” after the end of 2020. [Hungary](#), as

noted, has reduced its D-SIB buffers to zero, but has outlined plans for increasing them, starting in 2022.

### Conditions for Use of Capital

More than 25 countries cited increased support for lending to businesses and households and maintaining financial stability as primary reasons for freeing up capital by reducing capital buffers. In the [words](#) of the Hong Kong Monetary Authority's chief executive: "Lowering the countercyclical capital buffer at this juncture will allow banks to be more supportive to the domestic economy, in particular those sectors and individuals that are expected to experience additional short-term stress due to the impact arising from the outbreak."

Some countries, like Belgium and [Estonia](#), said they were releasing their buffers to absorb the impact of greater loan losses that may occur during the expected COVID-19 recession. [France](#), Sweden, [Poland](#), and others cited expanding credit to small businesses as the goal of reducing their CCyBs. Sweden's central bank head [said](#): "[W]hat we are doing is freeing up significant lending capacity for the banks."

### Quality of Capital

The [European Central Bank](#) said it will allow banks to use lower-quality Additional Tier 1 or Tier 2 capital to meet their core-capital requirements. [Slovenia](#) took that advice. However, we are not aware of other countries, either in Europe or elsewhere, that have pursued this option.

### Changing Risk Weights

Risky assets have higher risk weights than safe assets like Treasuries and consequently require a bank to hold higher capital buffers to mitigate potential losses. By reducing the risk weight calculations of certain categories of assets, governments can ease a bank's regulatory capital requirements and support the supply of credit to those assets.

The [Netherlands](#) has postponed the implementation of a floor on the risk-weighting of mortgages; this means there is no minimum risk weight for mortgages, as planned, which would have required holding a higher capital buffer. The [Russian](#) central bank recommended that banks and other credit institutions, when calculating their capital adequacy ratios, disregard adjusting the risk weights of loans to individuals that have been infected with coronavirus. Like the Netherlands, Russia has reduced the add-ons to risk weights for mortgage loans. Russia is also [eliminating](#) risk weights for foreign currency loans until the end of September for companies making pharmaceutical or medical products.

[Kazakhstan](#) has reduced risk weights for loans to small and medium-sized enterprises from 75% to 50%, and for foreign-exchange loans from 200% to 100%, to support lending.

The Federal Reserve changed its supplementary leverage ratio rule to exclude Treasury securities and deposits held at the Federal Reserve banks from the calculation of the leverage ratio for bank holding companies. This temporarily reduces the Tier 1 capital requirements for financial institutions with over \$250 billion of assets by about 2% relative to their 3% minimum. The United States has also recently passed legislation to implement the Paycheck Protection Program, which will support provisioning of partially forgivable loans to SMEs. New loans made under this program will have a zero risk weight.

Similarly, the Japanese central bank and regulator said they would [temporarily revise](#) the leverage ratio to exclude banks' accounts at the Bank of Japan.

### Countercyclical Capital Buffer (CCyB)

Released: [Belgium](#) (from 0.5%), [Denmark](#) (1.0%), France (0.25%), [Germany](#) (0.25%), [Iceland](#) (2%), [Ireland](#) (1%), [Lithuania](#) (1%), [Sweden](#) (2.5%), [Switzerland](#) (remains 2% on mortgage exposures), [UK](#) (1%)

Lowered: [Hong Kong](#) (from 2% to 1%), [Norway](#) (2.5% to 1%)

Cancelled planned increase: [Bulgaria](#) (held at 1%), [Czechia](#) (1.75%), France (0.25%)

Set at zero indefinitely: [India](#), [Italy](#), [Russia](#), [Spain](#)

### Capital Conservation Buffer (CCB)

Specifically lowered: [Brazil](#) (to 1.25%), [Oman](#) (1.25%), [Sri Lanka](#) (1.5% for large banks, 2% for others), [UAE](#) (1%)

Lowered but with no new target specified: European Central Bank, [Malaysia](#), [Russia](#), [Slovakia](#), [South Africa](#)

Delayed implementation of full buffer: [India](#) (now at 1.88%), [Ukraine](#) (0.63%)

### Systemic Risk Buffer (SRB) and Domestic Systemically Important Bank (D-SIB) Surcharge

Lowered: [Australia](#) (various to 0%), [Canada](#) (from 2.25% to 1%), [Estonia](#) (1% to 0%), Denmark (3% to 2% for [Faroe Island exposures](#)), [Finland](#) (range of 1%-3% to 0%), [Hungary](#) (0.5%-2.0% range to 0%), [Netherlands](#) (3% to range of 1.5%-2.5%), [Poland](#) (3% to 0%), [UAE](#) (various to 0%)

Maintained: [United Kingdom](#)

### Other capital easing

[Aruba](#) (lowered capital adequacy ratio from 16% to 14%), [US](#) (allowed bank holding companies to exclude Treasuries in calculating the supplementary leverage ratio; lowered leverage ratio for community banks from 9% to 8%), Japan (allowed banks to exclude central bank accounts in calculating the leverage ratio)

### Generic statements on use of buffers

[US](#), [Japan](#)