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Q&A about the increase of the countercyclical capital buffer

The Systemic Risk Council has an advisory function. The purpose of the Council is to suggest initiatives to prevent or reduce systemic financial risks that may put all or parts of the economy under pressure. The most recent financial crisis had a negative impact on economic development. One of the Council's tasks is to assess what is a suitable level for the countercyclical capital buffer.

A tool for ensuring a more resilient financial sector

The buffer is a tool introduced in international regulation after the financial crisis. The buffer is part of an extensive set of reforms to make the financial sector more resilient.

What is the countercyclical capital buffer?

The buffer is a capital requirement imposed on banks and mortgage credit institutions. The overall purpose is to build up capital in good times to be released in bad times. This means that the requirement is reduced when the financial sector is under pressure. Releasing the buffer aims to prevent the banks and mortgage credit institutions from constraining their credit supply in a crisis due to capital shortfalls. The purpose is not to halt soaring house prices or excessive lending growth when the economy is expanding, but to make the institutions more resilient.

What does the buffer requirement mean in money terms?

A 0.5 percentage point increase of the countercyclical buffer to 1.5 per cent will add kr. 7 billion to the total regulatory equity requirement for Danish banks and mortgage credit institutions. The higher buffer does not entail expenses of kr. 7 billion, but it means that a larger share of the institutions' lending activities needs to be financed by equity rather than debt.

There are no Danish institutions that breach their capital requirements as a result of an increase in the countercyclical capital buffer to 1.5 per cent.

How can the institutions meet the higher requirement?

The buffer requirement means that a larger share of the banks and mortgage credit institutions' lending needs to be financed by equity instead of debt. The institutions can achieve this by retaining earnings rather than distributing earnings as dividends or share buy-backs. In 2018, the sector's earnings totalled kr. 32 billion.

Irrespective of whether earnings are distributed or retained, they belong to the shareholders as owners of the institution.

Why should the buffer be increased now?

The buffer must be of a certain size to make a difference. Consequently, the Council finds it important that the buffer should be built up in periods like the current period with an economic upswing and expansionary financial conditions. A higher buffer makes the banks and mortgage credit institutions more resilient when the tide turns.

Will the buffer be increased further?

That depends on developments in the financial system. The buffer rate is not set mechanically on the basis of individual indicators, and given the uncertainty of measuring risk development, the Council's recommendations regarding the buffer rate will always be based on an overall assessment of financial developments. The Council expects to recommend a further increase of the buffer rate by 0.5 percentage point in the 3rd quarter of 2019 unless the risk build-up in the financial system slows down considerably.

Who decides whether to increase the buffer?

The Minister for Industry, Business and Financial Affairs decides the buffer rate level. Every quarter, the Systemic Risk Council assesses the level of the buffer rate. If the Council finds that the buffer rate should be changed, it will publish a recommendation addressed to the Minister.

Can the Minister refuse to comply with a recommendation from the Systemic Risk Council?

Yes. However, the Minister must either comply with the recommendation or explain why it is not complied with.

Do other countries have a buffer?

Yes. Bulgaria, France, Ireland, Iceland, Lithuania, Luxembourg, Norway, Sweden, Slovakia, the UK and the Czech Republic have positive buffers. National decisions to activate the buffer or increase the buffer rate are founded on a broad information basis, where relevant indicators have pointed to the build-up of risk.

Has the buffer been activated in Denmark?

Yes. The buffer was activated in 2018 with a buffer rate of 0.5 per cent with effect from 31 March 2019. See the first recommendation [here](#), Q&A about activating the buffer [here](#) and the minister's response (in Danish) [here](#).

The buffer was increased to 1 per cent with effect from 30 September 2019. See the recommendation of raising the buffer [here](#) and the minister's response (in Danish) [here](#).

Do foreign banks have to fulfill the higher Danish requirement?

Yes. Other banks with credit exposures in Denmark will also have to meet the Danish countercyclical capital buffer. That follows from the EU legislation.

Is the buffer a guarantee against a new financial crisis?

No. The buffer is an instrument aimed at preventing banks from reducing their lending too much if a new financial crisis occurs.