EUROPEAN CENTRAL BANK

EUROSYSTEM

Discussion of „Calibrating the Magnitude of the Countercyclical Capital Buffer Using Market-Based Stress Test" by Maarten R.C. van Oordt

ECB Macroprudential Stress Testing Conference

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Research question

- What should be the maximum level of Countercyclical Capital Buffer (CCyB cap)?
- Which indicators can support CCyB setting?

Methodology

- Estimate point-in-time prudential capital ratio (stress testing)
- Derive the difference between actual and point-in-time capital ratios
- Regress this difference on the candidate indicators of systemic risks (and other control variables)
- Set CCyB cap as the predicted change in the LHS variable resulting from the peak-to-trough shift in the RHS systemic risk indicator

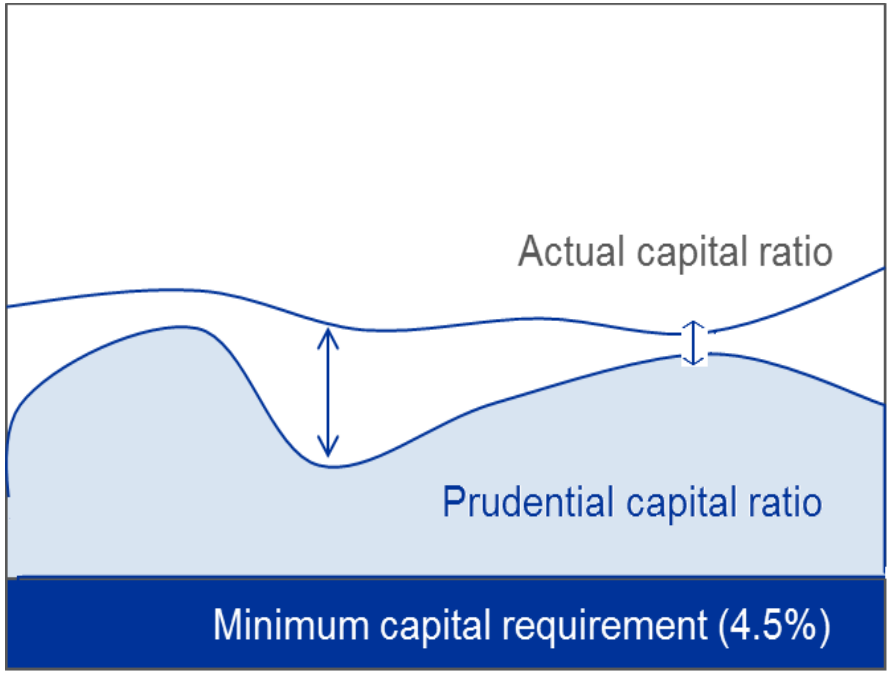
Strengths

- Very relevant research question
- Reasonable range of estimates…
  - 1.0-1.7% CCyB cap
- … and selection of indicators
  - Credit-to-GDP gap
  - House prices
- Emphasising the inherent relation between CCyB and stress testing
- An innovative combination of state-of-the-art statistical methodologies (CoVaR, GARCH-DCC)
- Comprehensive robustness checks

Question marks

- Do we talk CCyB?
- What is the implicit behavioural model of banks?
- Don’t we miss something by focusing on assets rather than risk-weighted amounts (RWA)?

Identification of the CCyB cap



Object of interest: the actual capital ratio at the peak of the financial cycle that prevents banks from falling below their prudential capital buffer in the though of the cycle

A buffer preventing crossing minimum capital requirements when a bank faces a period of persistently* low asset returns**

*6 months ** 5th percentile of asset return distribution

CCyB check list

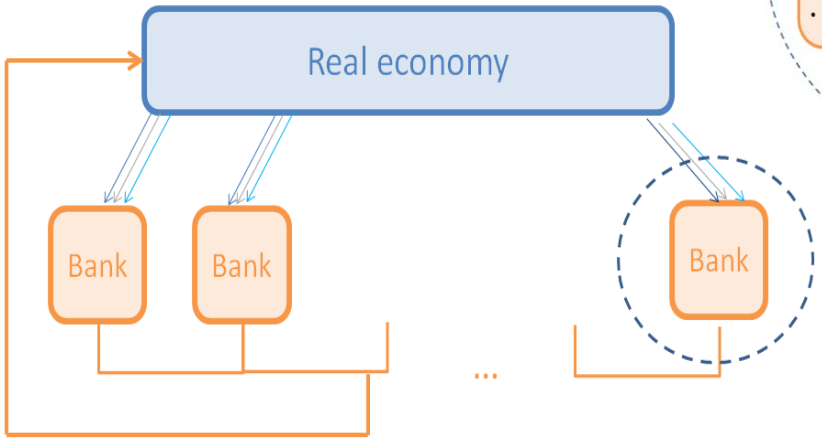
- **CCyB as one of capital buffers**
  - The role of other capital buffers (conservation buffer, G-SIB) in absorbing the shock
- **CCyB as the instrument that builds the system resilience**
  - Is there any relationship between bridging prudential buffer and banks' deleveraging?
- **CCyB as the instrument that tames the cycle**
  - How does the accumulation of capital affect lending in good times?
  - How does the accumulation of capital relate to risk-taking by banks and the cyclicality of risk weights?

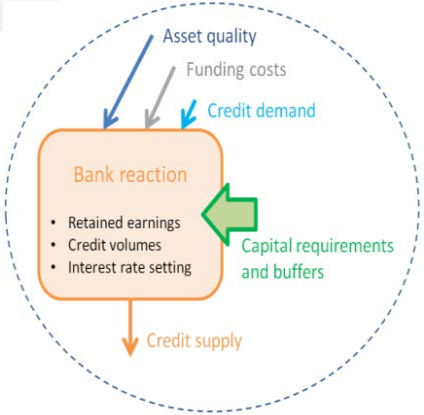
Implicit banks' behaviour

- Prudential buffer prevents banks from bridging minimum capital requirements (falling into insolvency)
- ... but why do banks hold **actual buffers above this level?**

Comparing the approach to the ECB macroprudential stress test

19 SSM (25 EU) economies +





+ 91 (101) significant SSM banks

- BEAST links the dynamics of macroeconomies and individual banks
- Detailed exposition of banks' balance sheets and profit and loss accounts
- Dynamic balance sheet
- Two types of amplification mechanisms: real economy-financial sector, solvency-funding costs
- Stochastic macroeconomic scenarios

The interpretation of the buffer in the ECB setup

Object of interest: the level of regulatory capital buffers that once released can reduce banks' deleveraging and prevent shock amplification in an adverse scenario

- **Exposition**
  - Accounting for the full set of capital requirements
- **CCyB as the instrument that builds the system resilience**
  - Data-based identification of the capital ratio that prevents banks' from excessive deleveraging
- **CCyB as the instrument taming the cycle**
  - The model incorporates the cyclicality of risk weights