BANKING METRICS · EPISODE 13

BANKING METRICS SERIES · CAPITAL RATIO TOPIC

THE COUNTERCYCLICAL BUFFER

CCyB — the buffer that grows in credit rally and is released in crash.
One rate per country, every quarter.

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A Buffer That Moves With the Cycle

The CCyB is the only capital buffer designed to change over time: up in booms, down in busts.

Every quarter, a designated authority in each country sets one CCyB rate for credit exposures located there. Banks then build their own requirement from those national rates — and meet it entirely with CET1.

0 – 2.5% THE RANGE	**The rate.** Normally between 0% and 2.5% of RWA, moved in steps of 0.25%. It can go above 2.5% when the authority judges credit growth extreme.
GUIDE THE SIGNAL	**The credit-to-GDP gap.** How far credit has grown above its long-term trend. Basel uses it as the common starting point, authorities then layer judgement and other indicators on top.
TIMING THE ASYMMETRY	**Slow up, fast down.** When the buffer increases, normally it is binding only 12 months after they are announced, so banks build capital gradually. When the buffer decreases, cuts apply immediately, i.e., when the capital is needed.

Why it exists at all

The 2008 lesson: fixed requirements are procyclical. The CCyB accumulates capital while credit is cheap, precisely so it can be handed back when losses arrive.

KEY TAKEAWAY

One rate per country, reset every quarter, met with CET1. The only buffer in the stack that is meant to be built up — and then deliberately released.

The Buffer is a weighted average

No bank applies a single country rate. Its own CCyB follows the map of where it lends.

The rate in one line

A bank's own CCyB rate is the weighted average of the national rates in every country where it holds relevant credit exposures. Each country weighs in for the share of the bank's total own-funds requirements for credit risk that comes from borrowers located there.

$$\text{Institution CCyB} = \Sigma \ \text{country rate} \times \text{country weight}$$

What goes into the average

- **Relevant exposures:** private-sector credit only: corporates, retail, trading book and securitisations. Sovereigns and banks are excluded.
- **Location:** an exposure sits where the borrower is, not where the loan is booked. A Milan bank lending to a Swedish firm would pick up the Swedish rate.
- **Weight:** The weights are applied based on the country share of the bank's own-funds requirements for credit risk.

KEY TAKEAWAY

Two banks with identical balance sheets can carry different CCyB requirements. What matters is not where the bank sits, but where its borrowers do.

The release is the whole point

THREE COUNTRIES · ONE WEIGHTED AVERAGE

0.9%

the CCyB of a bank with 60% of its credit requirements at a 0.5% rate, 30% at 2.0% and 10% at 0%.

The mechanism

Say 60% of the bank's own-funds requirements for private credit sit in a country at 0.5%, 30% in one at 2.0% and 10% where the rate is 0%.
The average: 0.6*0.5 + 0.3*2 + 0.10*0 = 0.9% of RWA, in CET1, which needs to be held on top of every other buffer.

A real situation:

In March 2020, authorities across Europe cut their CCyB rates to zero within days, in order to free CET1 capital to absorb losses due to Covid period and keep credit flowing.

The CCyB is, in simple terms, a shock absorber: built when the economy looks good, released in a recession or crisis period, one country rate at a time.

This is Episode 13 of the Banking Metrics Series. Each episode takes one key metric that banks disclose under Basel III, breaks it down from first principles, and illustrates it with real data