Secretariat of the Basel Committee on Banking Supervision

Bank for International Supervision

CH-4002 Basel

Switzerland

16 April 2010

Dear Sirs,

Strengthening the Resilience of the Banking Sector

We are writing on behalf of The Royal Bank of Scotland Group and Banca Akros. We share common concerns regarding the issues noted below, and ask that you consider these.

This joint comment refers to specific elements of the leverage ratio with further detail in the following pages. This is a repetition of comments already made in the RBS Group response to your consultation which also been submitted today.

Regards,

John Cummins	Marco Turrina
RBS Group Treasurer	Banca Akros SpA Chief Executive Officer

Basel Committee for Banking Supervision
Consultative Document 164: Strengthening the Resilience of the Banking Sector

Leverage ratio

Key Concerns

1. We understand regulators desire for a simple fallback measure. Our comments are aimed at ensuring such a measure does not create unintended consequences and achieves the objectives regulators have set themselves. We understand those objectives to be:

    - ability to monitor (and where appropriate control) overall leverage in the system.
    - a measure to supplement risk sensitive capital requirements.
    - ensure sufficient funding liquidity is present.

Our key message is that only a leverage ratio that is institution specific would achieve these objectives. This does not undermine the requirement for simplicity and comparability that are a hallmark of the proposals, which should be maintained for calculation purposes. But we do see it as essential that any leverage ratio that is actually set as a binding requirement for a specific institution takes account of its specific business mix. This will not make it a risk sensitive requirement but it does mean that regulators and firms could have a sensible debate as part of their Pillar 2 discussions about what ratio is appropriate for a firm, focussing on variability of trends and recent changes rather than ratio levels which may not be transparently comparable across firms.

Such an approach is particularly important given the calibration debate. An inappropriately calibrated leverage ratio is likely to lead to additional risk taking by some institutions, while hurting those that run low risk operations. There is in our view no single calibration that could avoid such consequences. We would therefore argue strongly for institution specific leverage ratios, combined with a “comply or explain” Pillar 2 approach.

This approach, which we commend to regulators, will still allow the regulatory community to monitor overall leverage in the system, given that it maintains a uniform calculation which ensures comparability and the possibility of aggregation. Aggregation in turn will allow monitoring of the leverage in the system. However, the firm specific discussions will enable the monitoring to be much more effective, as the underlying drivers can be understood much more easily. Indeed, we would suggest that even for individual firms the process of monitoring, analysing and discussing trends in their leverage is what would provide the main benefit of a leverage ratio.

A particular concern is that trading activities are hit particularly hard if no netting is allowed. If that result is intentional we consider that the regulatory concern should be addressed as part of the supervisory review of trading activities rather than indirectly via a crude leverage ratio. We note that current proposals, which are already at the implementation stage, have already hit trading activities significantly. An additional concern is that under the proposed calculation methodology trading book impacts could add significant volatility to the leverage ratio. An implication from this is that firms involved in these activities would need a higher leverage ratio buffer, which would make a leverage ratio binding much earlier than a simple ratio would suggest.

Finally we would like to add that it is inappropriate to generalise from the few and restricted leverage ratios that operated in certain jurisdictions during the recent crisis and assume that the new proposals would have the same benefits. On the contrary we would be concerned that the significantly wider current proposals would be ineffective in comparison to existing schemes. We

say this because existing leverage ratios were targeted to certain types of banking structures appropriate for their respective jurisdictions and did not have the broad scope that the new proposals have.

Detailed Issues

2. We read the Committee's proposals as suggesting that a leverage ratio applies on a consolidated basis. Certainly for monitoring the overall leverage in the system a group leverage ratio ought to be sufficient. If the leverage ratio is also applied to individual subsidiaries, as currently proposed in the EU CRD4 working paper, we feel that this would cause additional complexity around the treatment of intra-group transactions and will complicate balance sheet and treasury management across the Group. This reinforces the importance of the Committee implementing a useful and practical leverage ratio measure that can be meaningfully used in supervisory reviews.

3. To us the proposals represent an extreme scenario, well in excess of the plausible requirements that are generally required for stress tests. This reduces the usability of such a ratio for management purposes. We nevertheless recognise regulators' desire to introduce a simple measure. This reinforces the need to have the proposals implemented on an institution specific basis, otherwise business models relying heavily on risk mitigation, with appropriate netting and holding security will be negatively impacted.

4. Netting – We would favour a consistent approach to netting, as opposed to no netting. This is because we feel that legally enforceable netting, particularly if recognised for accounting purposes, is an important risk mitigant that should be recognised by regulators. While we accept that there are differences between jurisdictions, we are not convinced that these are material enough to justify a position of no netting.

5. Repurchase transactions and securities lending transactions – We feel that the risk of such activities is incorporated in liquidity requirements and it would not be appropriate to also manage this on a gross basis for the leverage ratio. We assume that the netting proposals in this instance refer to netting against the same counterparty, in which case we are of the view that netting should be allowed.

6. Securitisations – We would prefer alignment to regulatory de-recognition rules as these are more representative of the real risks. Regulators have significantly tightened up the significant risk transfer requirement and therefore we do not see the benefit of using the accounting treatment. Finally the alternative proposed of no de-recognition will simply make the leverage ratio less relevant to the real need of both regulators and firms.

7. Derivatives – We would support an accounting approach with netting and appropriate off-sets. While we accept that this would not take into account future potential exposure, we are not clear about the rationale for incorporating future potential exposure. It is our understanding that the leverage ratio does not have a one year horizon, or a similar concept. As a result we feel that the accounting approach is appropriate. We have already explained why netting should be allowed.

8. Credit derivatives – As already indicated we feel that netting and where appropriate off-setting should be recognised, at least to the extent allowed in the market risk framework. Without such recognition we feel that trading activities are treated more harshly than other banking activities. This is because trading activities, unlike most banking book activities, are undertaken on the basis that risks can be hedged away. As a result the non-recognition of netting and off-setting has a more punitive effect on these activities. This is one of the reasons why we say that a single leverage ratio across all institutions is not workable. The appropriate place to address concerns with credit derivatives is the capital requirement calculation, not the crude methodology of the leverage ratio. A further difficulty we have with the current proposals is that they suggest a punitive approach to credit derivatives by overstating the maximum possible loss. We suggest some reference along the lines used in the comprehensive QIS: "For a short position this limit could be calculated as a change in value due to the underlying names immediately becoming default risk-free. For a long risk

position, the maximum possible loss could be calculated as the change in value in the event that all the underlying names were to default with zero recoveries".

9. Other off-balance sheet items – While we accept the need for simplicity in any leverage ratio calculation we would urge regulators to consider the effect this has on the wider economy. We would urge the Committee to take account of the secondary effects of depriving commercial companies of the benefits of undrawn credit facilities and letters of credits, which this proposal will lead to. This is particularly important in the current environment where firms more than at any other times need to be able to access liquidity at short notice. We are convinced therefore that behaviourally the inclusion of many such off-balance sheet items will hit the vulnerable parts of the economy, such as SME's and firms relying on international trade.

10. Disclosure – While as a general statement we are in favour of Pillar 3 and the additional transparency it provides, we are doubtful that in the case of the leverage ratio disclosure would achieve regulatory objectives. This is because as a measure it does not actually contain any comparability between firms, given the different business models that are in place and the overly simplistic assumptions made in calculating it. We would therefore caution regulators against forcing firms to publish a ratio which can only be sensibly used in a firm specific context. We would have no objection to private disclosure of leverage ratios to our supervisor as part of a Pillar 2 dialogue.