

16th September 2013

Secretariat of the Basel Committee on Banking Supervision
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Dear Sirs,

BCBS251: Revised Basel III leverage ratio framework and disclosure requirements

Barclays welcomes the opportunity to comment on the proposed amendments to the Basel Committee's 2010 proposals. We responded to the Basel Committee's original proposals outlined in BCBS 164 and recognise that some of the concerns raised were addressed in BCBS 184. Barclays has contributed to the joint GFMA/ISDA/IIF response and is broadly supportive of comments contained therein. We are also participating in industry studies on the effects of leverage which will be shared with the Committee in due course.

Barclays understands the importance of the leverage ratio to Regulators globally and supports the use of a leverage ratio as a backstop measure to inform regulators of the potential need for action which cannot be adequately assessed via risk based capital requirements or other regulatory backstops. This ratio must by design capture items that are relevant to the determination of leverage, yet be cognisant of the fact that banks will and are required to hold "exposures" that support other regulatory objectives such as robust risk management, higher liquidity standards and greater transparency via the use of central clearing. It is in this light that we raise the following concerns.

1. Netting, Collateral and Securities Financing Transactions ("SFTs")

Netting and Collateral

We are supportive of the Committee's approach to seek harmonisation across institutions operating in different jurisdictions and under different accounting standards. The proposed approach of disallowing netting would certainly lead to harmonisation across US GAAP and IFRS reporters. However, this aim could also be achieved through recognition of bilateral legally enforceable netting with the added benefit of addressing the concerns we outline below.

It is imperative that items which mitigate leverage are fully considered alongside those items that create leverage - netting is one means by which this is achieved. The appropriate recognition of netting produces a measure that most faithfully reflects a bank's leverage position. We illustrate this in Appendix 1 where we highlight the fact that under the Committee's proposed measure, transactions with identical exchanges of cash and having seemingly identical leverage characteristics can generate very different leverage exposure outcomes dependent upon the recognition of netting.

We are of the view that all regulatory tools available should be designed in a manner to be consistent in their promotion of regulatory objectives. The Committee's 2010 standards on leverage implemented netting of SFTs and the Committee's current proposals continue to recognise netting of replacement cost for derivative transactions on a legal rather than accounting basis. We therefore do not see the rationale or the need to remove netting effects for SFT transactions, and more generally, why netting is not considered for legally enforceable bilateral cash balances such as loans and deposits. We have provided an example in Appendix 2 of a typical cash pooling product used widely in the industry and cost implications if legally enforceable netting is disallowed for leverage.

Collateral is an example of good risk management practice. The Committee appears to maintain its general stance that credit risk mitigation should not be reflected in the exposure measure. We would suggest though that where it can be demonstrated that collateral amounts, be they cash or securities, are legally and operationally held in a manner to prevent further leverage in the system, then such amounts should be excluded from the leverage measure.

SFTs

The proposals as drafted add an incremental exposure to the leverage measure reflecting the counterparty exposure on SFT transactions. Where these are subject to netting arrangements, the exposure can be netted against the total amount of collateral received and positive amounts are reflected in the leverage measure.

We question whether the "E-C" component is relevant to a measure of leverage. We certainly agree that for risk based capital requirements it is relevant to capture the counterparty risk inherent in such arrangements and this is achieved in the current risk based measures such as the Financial Collateral Comprehensive Method ("FCCM") or Internal Model Method ("IMM"). However, in the context of leverage, this would appear to be a "double counting" of exposures given the assets leg of such arrangement are already caught within the exposure measure and are not reduced by the receipt of collateral.

It is our view that the proposals as drafted in relation to SFTs will result in a decrease in the size of the global SFTs markets including the repo markets where the majority of transactions are against government securities as collateral. Market liquidity is likely to be reduced resulting in increased price volatility in the relevant SFT and cash markets and ultimately higher costs for borrowers.

Liquidity risk associated with SFTs, and as highlighted during the crisis of 2008, is being successfully addressed by the introduction of strong liquidity metrics in the Basel III framework via the Liquidity Coverage Ratio. Furthermore, the risk based capital requirements are calibrated to ensure incentives are aligned to activity associated with high quality collateral. The outcome of the proposed leverage measure in respect of SFTs would appear disproportionate to both their risk and leverage profile.

2. Central Clearing Counterparties ("CCPs")

We are deeply concerned as to the treatment of derivative and SFT transactions with CCPs. The G20 mandate is to promote greater market transparency and support central clearing. We are concerned that the proposals as drafted may inadvertently undermine this objective, as the framework applies an approach that does not distinguish between bilateral, OTC transactions and central clearing models

We are aware of the Incentive Assessment QIS that is being coordinated by national regulators on behalf of the Basel Committee. Our understanding however is that this exercise is reviewing incentives solely from the perspective of risk based capital requirements. Furthermore, the timing of this important exercise presents challenges for institutions given the implementation of Basel III. We therefore urge the Committee to expand the remit of this exercise and provide more time to complete the study, in order to capture the incentive effects associated with leverage. In particular the exercise should seek to examine and address:

- Differences in clearing models and their outcomes for leverage. In particular, a comparison of the European "principal" model and the economically identical US "FCM" model.
- Dependent upon the clearing model adopted, a clearing member could find itself with 2-3 times the leverage outcome compared with a bilateral OTC transaction for the Potential Future Exposure ("PFE") component alone. We illustrate this in Appendix 3.
- The treatment of margin balances where such amounts are segregated and cannot be subsequently leveraged. Consideration needs to be given as to whether such amounts should be excluded from the leverage measure.
- Consideration of whether default fund contributions are seen as "capital" items and captured in the numerator or whether they are viewed as "exposure" items and captured in the denominator. The difference in the leverage outcome is 1x compared to 33x assuming a 3% leverage ratio. Default funds are key risk mitigants of counterparty and systemic risk and therefore should be encouraged.

Barclays would be pleased to work with the Committee to ensure appropriate calibration for all CCP related items in order to maintain appropriate incentives and alignment with the G20 mandate to promote central clearing of OTC derivatives.

3. Derivative Exposures

We note that the Committee is considering under a separate consultation the merits of the Non Internal Model Method ("NIMM") for calculating exposures on derivatives. This is expected to be a more risk sensitive replacement of the Current Exposure Method ("CEM") approach. The Committee is undertaking a Quantitative Impact Study ("QIS") in relation to NIMM to consider the impact of replacing CEM on risk based requirements. We would request that the Committee expands this study to consider the effects on leverage in order to provide a holistic impact of the NIMM methodology.

The Committee has proposed an additional measure for written credit derivatives. Whilst we recognise that there is leverage contained in written CDS contracts, we do not understand why the proposals target CDS contracts in particular as the potential for leverage exists in all derivatives. Taken to an extreme, a simple interest rate swap could be replicated as a loan and deposit.

Should the Committee conclude that leverage contained in CDS contracts should be captured by the measure, Barclays supports the recognition of offsets against bought CDS contracts. We would however appreciate greater clarity around other "eligible hedges" when considering the effects of single name CDS, CDS Indices, CDS Index tranches and bespoke correlation products (nth to default and portfolio tranches). In particular, we suggest:

- Indices should be able to be split into their single name components when considering offsets.
- Where the reference asset or pools are identical and the seniority of the purchased CDS protection is lower in the capital structure than the seniority of the sold CDS position, offset should be allowed.
- For bespoke correlation products, the Effective Notional should represent the notional equivalent delta for each single name. Offsetting of long positions against short positions should be performed on the basis of Reference Entity, on a notional equivalent basis. For Index Tranches, the Equivalent Notional should be set to the delta of the tranche which then is decomposed into single name components.
- The recognition of offsets in instances where there is a mismatch in maturity.

The introduction of the written CDS treatment does raise the question of how synthetic positions are reflected in the leverage measure in order to capture an outcome that is as close as possible to the real world leverage that is created. In our view, if banks writing protection reflect the long position in accordance with the Committee's proposals, then banks hedging cash instruments (loans and bonds) via eligible CDS hedge should report a net exposure. Adoption of this approach ensures that double counting of leverage is eliminated. We would also highlight that for written CDS with negative replacements cost, the current proposals do not capture the effects of negative replacement costs which leads to an overstatement of the synthetic exposure when assessed on notional terms. This is inconsistent with the exposure measure of a bond trading below par.

4. Banking Models

The nature of banks' balance sheets reflect the markets in which they operate. For example, the balance sheets of European banks are characterised with a greater proportion of low yielding mortgages relative to their US peers who have access to various US agencies to support the residential mortgage market. In Europe, CRD IV requires the European Commission to submit a report by end 2016 and, where appropriate, legislative proposals on the appropriate calibration of capital, exposure measures and the leverage ratio relevant to different banking models. Whilst we would not seek to pre-judge the outcome of the report, we believe that this issue should be for international consideration in the context of calibration of the leverage ratio. We are happy to engage in dialogue to consider how best this can be reflected in the leverage measure whilst maintaining simplicity and transparency.

5. Scope of Application

We encourage the Committee to establish a consistent scope of application for the leverage ratio at the group consolidated level and any lower tier levels of an organisation. This is particularly important given the distortive effects of a leverage ratio when applied to different levels of an organisation established in multiple jurisdictions.

Establishing a consistent scope of application with respect to the leverage ratio is especially important in the context of the Notice of Proposed Rulemaking issued by the Federal Reserve in December 2012 regarding foreign banking organisations operating in the United States, and the possibility that other non-U.S. jurisdictions may consider similar initiatives. We provide further details in Appendix 4.

6. Credit Conversion Factors ("CCFs")

Whilst recognising that the goal of simplicity in the leverage measure and the Committee's aim of capturing future sources of leverage, we encourage the committee to consider the application of CCFs as applied to leverage. The current proposals apply a 100% CCF in all instances with an exceptional treatment of 10% for items which are unconditionally cancellable without notice. We would argue that off balance sheet items require an assessment of the likelihood of future leverage. In this regard, the Committee should look to its CCF rules for risk based capital requirements which include 20% or 50% CCFs for trade finance related activity and 0% for facilities that are automatically cancellable due to deterioration in credit worthiness of the borrower reflecting the low risk associated with such items.

On Trade Finance specifically:

- The products in question support hundreds of billions worth of global trade flows by providing financing and servicing for exporters and importers across in domestic and international markets. A significantly higher CCF via the leverage measure than that applied for capital calculations thus far should be expected to have detrimental consequences through higher overall costs on trade flows, impacting the global economy. While we agree that a significant amount of Trade contingents items should be converted at 100% CCF since they are Financial Guarantees or Standby Letters of Credit, we do not believe that the 100% assessment across all products is appropriate given the low historical conversion rates experienced by the industry for products such as Pre-Acceptance Letters of Credit (c. 30%) and Performance Bonds & Guarantees (c. 10%).
- In Appendix 5, we provide examples of the common product types which would be impacted and potential client impacts. An extreme example would be a scenario in which there are multiple bidders for a project (seven would not be uncommon) and each is backed by bid bonds. Only one bidder will win the project, but the industry as a whole would end up holding multiples of this (700% in the example above) with a consequent impact on pricing. We believe that a lower CCF should be applied across the industry.

We hope you find our comments and suggestions helpful. Please do not hesitate to contact myself or Dipal Patel (dipal.patel@barclays.com on +44 20 3134 1176) if you have any questions or comments on the issues raised in this response.

Yours faithfully,



Peter Estlin
Acting Chief Financial Officer & Group Financial Controller

Appendix 1

SFT Netting and Leverage Outcome

The table below outlines three scenarios and the impact on the asset side of the balance sheet in determining the leverage exposure.

Scenario	Bank A Leverage Exposure	Bank B Leverage Exposure
<u>Day 1</u>	Cash = 100 Leverage Exposure =100	Securities = 80 Leverage Exposure = 80
<u>Day 2</u> Bank A Reverses 70 of securities and lends 60 of cash to Bank B.	Cash = 40 Repo Asset = 60 Leverage Exposure =100	Securities = 80 Cash = 60 Leverage Exposure =140
<u>Day 3</u> Bank A Repo 55 of securities for 40 of cash with Bank B.	<u>No Netting</u> Cash = 80 Repo Asset = 60 Leverage Exposure =140 <u>With Netting</u> Cash = 80 Repo Asset = 20 Leverage Exposure =100	<u>No Netting</u> Securities =80 Cash = 20 Repo Asset = 40 Leverage Exposure =140 <u>With Netting</u> Securities = 80 Cash = 20 Leverage Exposure = 100

The table above highlights the two key reasons why we believe legally enforceable bilateral netting should be recognised in the leverage measure:

- The netted position on “Day 3” can be equally achieved by Bank A simply lending 20 to Bank B on Day 1. It therefore seems odd that leverage is created simply based on the legal form of an arrangement or the fact that an arrangement can be replicated via multiple transactions.
- The netted outcome delivers a leverage result that is identical to the actual leverage that is created. Bank B in the above scenario has only the ability to leverage its asset base by 20 reflecting the actual change in the cash position of Bank B.

Whilst the table above relates to SFTs, the same argument holds for loans and deposits i.e. Bank A lending 60 to Bank B in return for a deposit from Bank B of 40, will only have increased the asset base of Bank B by 20.

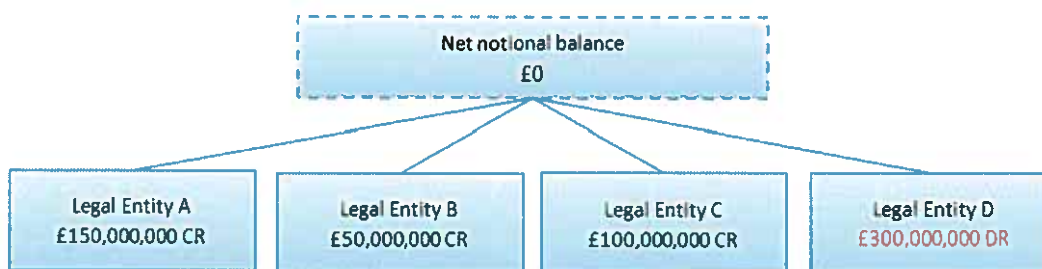
Appendix 2

Notional pooling balances with legal set off

Main features	<ul style="list-style-type: none"> • Cash pooling structures notionally consolidate debit and credit balances for the purpose of calculating interest without co-mingling funds • Typically and commonly used by companies with centralised Treasury functions but de-centralised payables and/or receivables management. Without this product it would be operationally very onerous for clients to manage their operational cash flows. • A single company can have multiple legal entities, each of which has a bank account that can either have deposit balances or be overdrawn • There is a single net limit that the overall client operates to – which is based on the net position of all accounts. Each account may be overdrawn by a much higher amount than the single net limit, but this should only happen if there is an offsetting deposit from the same client via another account • Because of the full legal right of set off (cross guarantees taken from participants in the pool), the net exposure for the bank will not be more than the net limit set for the client group. Both the bank and the client manage to the net limit. The credit balances effectively cash collateralise the debit balances. If these balances are to be reported gross the bank has little control over its reported leverage for this product. • Notional pools have been used for over twenty years in the UK, and are also available in many countries – used by most very large corporates in the UK and all major treasury centres. • Notional pools normally operate at a net credit balance.
Benefit of notional pooling to clients	<ul style="list-style-type: none"> • There can be a reduction in the amount of interest payable or increase in the amount of interest receivable • Client can manage pool balances as a single net position, improving access to funds and ease of management of liquidity position • Allows clients to operate different business lines and legal entities separately, without creating intercompany loan positions which have accounting, administrative and organisational implications

Example: Structure with £0 net limit for the client

- Significant increase in cost of working capital for client, because of increased capital required
- The significant increase in cost to clients and challenges with operational implementation of this change for banks are likely to drive away client appetite for the product
- The net result for clients is likely to be increased administrative costs, requirement for investment in systems to administer segregated accounting internally



	With netting for leverage	Without netting for leverage
Capital held by bank	£0	£9m p.a. (based on 3% capital requirement on gross balances)
Cost charged to client	£0	>= £1m p.a. (assuming 12% cost of equity)

Appendix 3

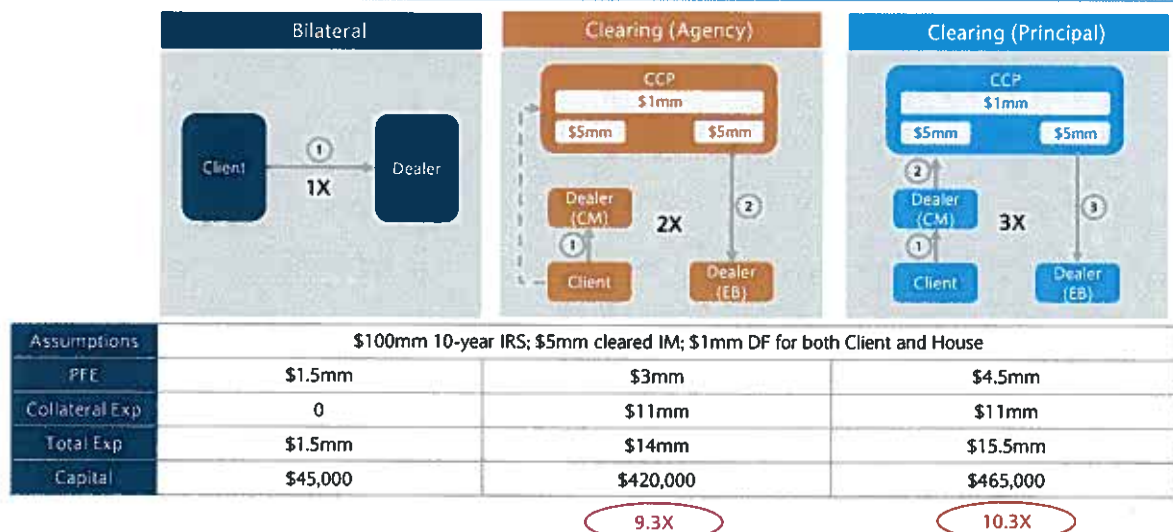
Central Clearing

The below illustrates the impact on leverage due to central clearing. Assuming a \$100m 10 year IRS, the move to central clearing will result in an increase in the number of trades to reflect the multiple transaction legs. Depending upon the clearing model, exposure increases by 2 to 3 times. The illustration ignores the incremental exposures generated by the MTM required to be met by clearing members.

Impact on Cleared Transactions – One Trade

Size of the exposure and the treatment of collateral requires further consideration...

- ❖ The one trade example below illustrates the over-stated exposure and capital implications of current revised leverage framework
- ❖ For the single transaction, leverage exposure in the clearing model can be 2X or 3X of that in the bilateral model
 - Agency model (such as FCM model required in the U.S.) clearly has an advantage in capital compared to the Principal model (such as SCM model required in the EU)
- ❖ Client collateral is counted as exposure as well. However, in the clearing models
 - This requirement doesn't take into account the fact that in some cases, Clearing Member (CM) has no access to utilize these assets for further leverage due to asset segregation



Appendix 4

Scope of Application

We encourage the Committee to agree a consistent scope with respect to application of the leverage ratio to an internationally-active banking organisation and any lower tiers of the organisation. For example, where a banking organisation operates in multiple jurisdictions, we would expect the leverage ratio applicable at the top tier of the organisation to be consistent with peer organisations. Similarly, we would expect any subsidiaries operating in host jurisdictions to be subject to leverage requirements on a basis consistent with peer organisations and subsidiaries operating in the host country.

For example:

Organisational level	Principle
Group (home country)	Leverage constraint applied to the consolidated organisation is comparable to peers
Subsidiary (host country)	Leverage constraint applied to a subsidiary or consolidated set of subsidiaries in the host country is comparable to host country peers

We highlight the importance of agreement on these principles given the competitive distortions introduced where these principles are contravened. The Notice of Proposed Rulemaking issued by the Federal Reserve in December 2012¹, for example, would require foreign banking organizations (FBOs) operating in the US to consolidate under an intermediate holding company and meet US leverage and risk-based requirements at the US holding company level. The proposal would, however, contravene the second principle above, since US organisations are not similarly required to meet US leverage constraints on a US basis (i.e. US-based Tier 1 capital against US-based assets) in a manner similar to that proposed to apply to FBOs. As a result, an FBO operating a primarily broker-dealer US presence is subject to leverage constraints not applicable to broker-dealer subsidiaries of US peers, introducing clear competitive distortions when operating in US markets. These distortions are not similarly reflected in risk-based metrics (given their implied adjustments for risk), which underscores the importance of adhering to the principles outlined above².

¹ <http://www.gpo.gov/fdsys/pkg/FR-2012-12-28/pdf/2012-30734.pdf>

² We have submitted a comment letter to the Federal Reserve's proposal expressing our concerns, including additional commentary regarding the geographic application of leverage ratios in Annex A that may be viewed at:

http://www.federalreserve.gov/SECERS/2013/May/20130528/R-1438/R-1438_043013_111125_559204980275_1.pdf

There are 59 additional comment letters on the Federal Reserve's proposal submitted by a variety of international banks, government officials, trade organizations and others that may be viewed at:

http://www.federalreserve.gov/apps/foia/ViewAllComments.aspx?doc_id=R-1438&doc_ver=2

Appendix 5

CCFs for Trade Products

CCFs specify the likelihood of a particular contingent exposure converting into an on-balance sheet item. Examples of Trade Product Categories are shown in the table below:

Product Category	Product Description	Conversion Risk
Performance Guarantee	<ul style="list-style-type: none">• Business A (exporter) is rendering a service / delivering goods to Business B (importer)• Bank guarantees performance of exporter with regard to this contract, paying importer a penalty when contract is not met	<ul style="list-style-type: none">• Exporter fails in their specific contract with importer• 100% CCF would be consistent with the expectation that exporters will fail on their client contracts in 100% of cases• However, global industry experience shows claims in only c. 10% of cases
Pre-acceptance LCs	<ul style="list-style-type: none">• Business A (importer) is committed to paying Business B (exporter) on delivery of specific goods• Bank issues a payment undertaking to exporter that importer / bank will pay on fulfilment of exporter's obligations	<ul style="list-style-type: none">• Exporter delivers their end of contract, all the required documents are in place from exporter and importer fails to pay• Global Industry experience shows claims in only c.30% of cases

Client Impacts where a 100% CCF is applied

The examples below assess the impact on Client if the CCF on trade products is applied as 100%. Pricing is based on the bank's return on capital. It is assumed that capital will be held at the higher of current capital requirements and new leverage requirements (i.e. that the leverage requirement is binding at a bank level).

Performance Guarantee:

Example 1: The Bank provides £50m performance guarantee to an exporter on a project for an overseas client.

- 50% CCF (current pricing) – exporter pays c. £275k
- 100% CCF – exporter pays c. £335k
- Price increase of 60k (c. 20%) driven by c. 50% more capital – this may increase the overall price of goods and services being sold by exporters for no increased risk

Example 2: The Bank issues an Import LC (sight) of £50m on behalf of a manufacturer to pay an overseas supplier for imported goods from abroad.

- 20% CCF (current pricing) – Manufacturer pays c. £125k
- 100% CCF – Manufacturer pays c. £255k
- Price increase of 130k (c. 100%) driven by c. 260% more capital – this will increase cost of raw material and hence price of finished goods for manufacturers