

September 20, 2013

Secretariat of the Basel Committee  
on Banking Supervision  
Bank for International Settlements  
CH-4002 Basel, Switzerland

Dear Basel Committee members:

**Re: CBA<sup>1</sup> Comments on consultative document:  
“Revised Basel III leverage ratio framework and disclosure requirements”**

We appreciate the opportunity to review the consultative document, *Revised Basel III leverage ratio framework and disclosure requirements*, dated June 26, 2013. We understand that the goal of this paper is to propose a robust and internationally consistent approach. We acknowledge that there may be adjustments to the definition and calibration of the leverage ratio up until 2017, and would welcome the opportunity to review these future adjustments prior to finalization.

We believe we offer a unique perspective on this topic given that Canada is one of the few jurisdictions worldwide that has required its banks to meet a leverage ratio requirement. To achieve prudent risk management, we believe that the risk-based capital ratios should be the predominant management tool for banks and that the leverage ratio should act as a complement or “back-stop” to the risk-based capital rules. As such, we believe that the Basel III leverage ratio should not be the binding constraint for banks that have a diversified business model under most scenarios.

We strongly believe that the Basel III leverage ratio should be consistently implemented across jurisdictions and that any level-playing field issues due to accounting regime differences should be mitigated via a regulatory solution. We understand that there is a tradeoff between simplicity (an objective of the leverage ratio) and accuracy (i.e. reflecting the true economics); nevertheless, we believe that bona fide counterparty risk mitigants, such as netting and collateral, should not be dismissed because they create comparability challenges among banks that report under different accounting frameworks. We also request that, to the extent the leverage ratio exposure measure is amplified as a result of simplicity/comparability being chosen

---

<sup>1</sup> The Canadian Bankers Association works on behalf of 56 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. [www.cba.ca](http://www.cba.ca).

over accuracy, the consequences of this amplification be appropriately considered when the final leverage ratio calibration is determined.

We encourage the Basel Committee to ensure that the Basel III leverage ratio only captures exposures that give rise to leverage. Indeed, not all exposures create, or can create, financial leverage, and so we believe non-leverage exposures (i.e. exposures that do not contribute to the build-up of leverage) should be excluded from the leverage calculation. We also believe that, in addition to being effective and proven credit risk mitigants, collateral and legally enforceable netting agreements would reduce the pressure on banks to liquidate positions into already declining markets during a stress scenario, and, as such, should be duly recognized in the leverage ratio measure of derivatives and Securities Financing Transactions (SFTs). Finally, the leverage ratio should consider the consequences of other areas in the regulatory framework, such as the Basel III liquidity rules. As such, in order to prevent “double-counting”, we believe the Basel III leverage ratio should exclude those off-balance sheet items that require banks to hold unencumbered High Quality Liquid Assets (HQLA) in order to meet the Liquidity Coverage Ratio (LCR) and defease the potential lending exposure.

We offer our comments on the consultative document below and in the attached detailed appendix.

## **Derivative Exposures and Collateral**

We feel the measurement of derivatives in the Basel III leverage ratio calculation is overly punitive, as it fails to recognize collateral and all legally enforceable netting agreements, both of which have been well tested and proven to mitigate counterparty credit risk, and would reduce the pressure on banks to liquidate positions into declining markets in a stress event, as noted above. The derivative exposure measurement may also fail to recognize netting through the use of qualified central counterparties (“QCCPs”). This is particularly noteworthy since regulators have encouraged banks to increase their use of QCCPs when partaking in over-the-counter derivative transactions, and QCCPs are generally less risky than bilaterally executed contracts given that their margining requirements are more robust. As such, we believe that explicit language should be included in the final rules to allow for netting of derivative transactions with QCCPs.

It should be noted that the proposal’s lack of recognition for netting cash collateral received unjustifiably overstates on-balance sheet derivative exposure. For example, if a bank has a derivative asset with a mark-to-market (i.e. balance sheet value) of \$10 and receives \$2 of cash collateral, the proposed leverage exposure for the on-balance sheet derivative exposure would be \$12 (i.e. \$10 plus \$2). However, the bank’s maximum on-balance sheet exposure if it did not re-hypothecate the cash collateral is \$8 (i.e. \$10 less \$2). Even if the bank re-hypothecated the \$2, the maximum on-balance sheet exposure would be \$10 (i.e. \$8 plus \$2), which is still less than the \$12 of on-balance derivative exposure that would be included in the proposed leverage ratio exposure measure. The on-balance sheet derivative exposure in the leverage ratio calculation should represent true economic exposure and this is not the case under the proposed treatment of cash collateral received.

Under International Financial Reporting Standards (IFRS), the cash collateral provided to a counterparty in a derivative transaction is recorded as an asset (i.e. cash collateral receivables) on the balance sheet and is thus included in the leverage ratio calculation. However, we believe

this asset should be excluded from the leverage ratio calculation since it is used to extinguish a mark-to-market receivable for the receiving bank (a liability for the paying bank) and hence does not give rise to financial leverage. As stated above, the Basel III leverage ratio should include, to the extent possible, only exposures that give rise to financial leverage.

It is also worth noting that a new approach is underway with a proposal on the Non-Internal Model Method (NIMM) for counterparty exposures. NIMM is being developed with the intention of correcting some of the apparent shortcomings embedded in the Current Exposure Method (CEM). Based on a preliminary assessment, it appears that the NIMM recognizes the benefit of collateral and is more reflective of legal netting arrangements than the CEM. The proposed modification to the treatment of collateral/netting in the risk-based capital framework for derivative exposure demonstrates that regulators recognize both collateral and legal netting arrangements as effective derivative counterparty risk mitigants. As such, we believe this evolved regulatory view towards the use of collateral/netting should be extended to the Basel III leverage ratio.

## **Securities Financing Transactions (SFTs)**

The proposed treatment for SFTs in paragraph 35 (i) and (ii) is very punitive as it requires the same exposure to be represented in the leverage ratio two ways: (i) its fully grossed-up accounting recognition and (ii) a counterparty credit risk measure calculated on a netting set basis subject to legally enforceable master netting agreements. We believe the leverage exposure measurement for SFTs (for banks acting as principal) should only be based on the net SFT assets after applying regulatory netting rules from the Basel II framework. This treatment would make it consistent with the SFT treatment that was referenced in the December 2010 Basel III rules text. Indeed, we believe the true economic exposure of an SFT is not based on a gross approach, but is based on the recognition of netting. In addition, we believe the final rules should allow for netting to be achieved through the use of QCCPs, since as mentioned above, banks are being encouraged to increase their transactions with QCCPs, and QCCPs are generally less risky than bilaterally executed contracts.

The application of regulatory netting rules based on the Basel III framework will not only better represent true economic exposure in the leverage ratio calculation, but it will also create greater consistency with the measurement of derivatives (which is effectively measured after applying Basel II netting rules). Further, level-playing field issues due to accounting differences would not occur with Basel II netting.

We note that the exclusion of netting for SFT assets risks further curtailing the repo market, a high-quality asset market in a stress event, resulting in a destabilizing effect to the economy. During a stress, banks are forced to scale back SFT volumes as they manage a multitude of factors, including capital requirements. The exclusion of netting in the Basel III leverage ratio will further constrain a bank's ability to sell or repo assets during a stress event, countering the objectives of the liquidity framework, which encourages banks to hold liquid assets so they can sell or repo assets in order to generate liquidity during stress events. As a result, banks may be forced to increase their dependency on government funding in a stress event in order to derive the needed liquidity.

In 1993 the Basel Committee agreed with the analysis in the Lamfalussy Report recognising that in addition to netting by novation, other forms of bilateral netting of credit exposures to the extent

that such arrangements are effective under relevant laws and comply with the other minimum standards set forth in the Lamfalussy Report. The Lamfalussy Report states that "[...] *netting can [...] reduce [...] the size of credit and liquidity exposures incurred by the market participants and, thereby contributes to the containment of systemic risk. [...] Moreover, the reduction in exposures relative to capital should reduce the likelihood that disturbances outside the netting scheme will lead to any one participant's insolvency. The reduction of exposures should also reduce the risks of secondary defaults within the group of netting participants and, thus contribute to a reduction of systemic risk.*" In the pursuit of a "prudent" regulatory treatment, we believe that the Basel Committee is ignoring all principles and benefits of netting laid out by the Bank for International Settlements' own research and findings over the years in order to avoid "...inconsistencies from netting which may arise across different [accounting] regimes."

## **Undrawn Loan Commitments and Other Off-balance Sheet Exposures**

The current proposal fails to consider a significant consequence of the Basel III Liquidity rules. The Basel III LCR requires a bank to hold unencumbered cash or other HQLA to cover the "total net cash outflow" over a 30-day period under a stress scenario. As the "total net cash outflow" includes off-balance sheet commitments, a Basel III leverage ratio that utilizes a 100% CCF for all undrawn loan commitments (other than those that are unconditionally cancellable) creates varying amounts of "double counting" as both the commitments and the liquid assets used to defease the commitments will be included in leverage exposure. This leads to a counterintuitive result whereby an undrawn loan commitment creates a larger exposure for leverage ratio purposes than a fully drawn loan of equivalent size. Using a simple example, the Basel III leverage ratio exposure for a \$100 undrawn loan commitment underpinned with \$100 of unencumbered HQLA, would be a \$200 exposure for leverage ratio purposes (whereas a fully drawn loan of the same amount to the same borrower would generate a \$100 exposures) despite the maximum loss potential to the bank being just \$100 in both instances.

We believe that the treatment of undrawn loan commitments in the Basel III leverage ratio should give consideration to the consequences of the LCR. We believe that this is best done by excluding the amount of undrawn commitments included in the LCR's "total net cash outflow" from the Basel III leverage ratio exposure calculation. An alternative solution would be to apply the CCFs (i.e. 20% or 50%) used in the risk-based capital framework to the loan commitments when calculating the Basel III leverage ratio.

An excessively conservative and illogical application of undrawn commitments, will, at the margin, reduce the ability of banks to provide undrawn loan commitments to highly rated customers, which can disrupt financing activities, the key driver for economic stability in any economy. Further, these commitments are usually extended to support high-credit-quality clients' financing activities, and are usually spread across a wide range of asset classes and business lines, thereby providing funding capacity in a low-risk and diversified manner.

In addition, and similar to the commitments described above, other off-balance sheet items such as direct credit substitutes, acceptances, standby letters of credit, etc. will be double counted in the leverage ratio, though it is left up to national supervisor to determine whether, and to what extent, these contingent outflows are to be defeased within the liquidity framework. This "national discretion" will promote an uneven-playing field, and might even force financial institutions in jurisdictions where the capital burden in leverage is double counted to exit the market, unable to compete. As such, we recommend that any off-balance sheet items that result

in “double-counting” in the Basel III leverage ratio be removed from the leverage ratio exposure measure. We note that as supervisors try to move away from reliance on LIBOR as a benchmark, off-balance sheet instruments (e.g. bankers’ acceptances) offer a certain appeal, but double counting in the leverage ratio makes it virtually certain that they will not be adopted in a wide-scale way.

## **Disclosure of the leverage exposure under the G-SIB methodology assessment**

Under the updated global systemically important banks (G-SIB) framework, banks with a leverage ratio exposure measure exceeding EUR 200 billion will be required by national regulators to publicly disclose the 12 indicator values, including the Basel III leverage exposure measure, on an annual basis, beginning four months after their 2013 financial year-end. As most banks already disclose the capital (numerator) under Basel III requirements, banks that are subject to the G-SIB disclosure requirements will effectively be disclosing the leverage ratio one year in advance of the leverage ratio disclosure requirements (i.e. the first quarter of 2015). As a result, banks subject to the G-SIB disclosure requirements may be required to disclose their Basel III leverage exposure measure based on the June 2013 consultative document and not on a final rules text. Although we understand that this issue will be considered by the Basel Committee, we wish to reinforce that the disclosure of leverage ratio exposures in 2014 will create international comparability challenges, including the potential that exposure calculations are based on different rules text. We recommend that the timing of leverage ratio disclosures be subject to the finalization of leverage ratio requirements, to ensure comparability for readers of these disclosures.

## **Calibration**

An inappropriately designed and calibrated leverage test risks becoming the binding capital limitation for retail banks running truly low-risk strategies. Since a bank will need to earn adequate returns to justify the capital needed to support the leverage test, if the leverage requirement operates as the binding capital limitation, it can push banks out the risk curve. In this situation, there is no incentive to decrease risk until the risk-based capital requirement exceeds the leverage capital requirement. We are concerned that a binding leverage ratio may discourage pursuance of good risk management practices. Accordingly, we strongly believe that the risk-based framework should represent the primary capital adequacy standard for banks and, as such, should operate as the binding capital limitation under most scenarios.

Canada has been well served by the assets-to-capital multiple (ACM), which has been a prudent and effective test that measures leverage in a logical way. It has effectively controlled leverage in the financial system (as can be seen by how relatively unscathed Canadian banks were during the financial crisis) without pushing banks out the risk curve. We believe that the proposed Basel III leverage ratio is sufficiently conservative at the 3% level, and that at higher levels would be more binding and result in unintended consequences. Accordingly, we believe that the Basel Committee should maintain the 3% ratio and no recalibration should be made until the exposure and the capital measures are adopted in their final form. We also stress that calibration should ultimately ensure that the leverage ratio does not become the primary binding capital constraint, rather than being a supplementary, backstop requirement.

The Basel III leverage ratio calibration should also consider future accounting changes that can impact balance sheet assets (and hence the Basel III leverage ratio), such as the International Accounting Standards Board (IASB)'s proposed standard on leases, which will impact the Basel III leverage ratio. The IASB is of the view that all leases should be recorded on an entity's balance sheet. This includes leases that do not transfer substantially all the risks and rewards of ownership of the leased asset to the lessee (currently referred to as operating leases in IAS 17). In addition, under the proposed rules, it is possible that the measurement of balance sheet gross up for certain leases (property being the asset that impacts the Canadian banks the most) may include an indeterminate number of the 'option-to-renew' periods, depending on the relative importance of the property to the lessee. This may result in the recognition of Right-Of-Use (ROU) assets much greater than that related to only the legal term of the lease.

The recognition of ROU assets on balance sheet would decrease the leverage ratio proposed by the Basel Committee simply through the gross up of assets on banks' balance sheets. In assessing how these accounting changes will be reflected in the Basel III leverage ratio, we encourage the Basel Committee to distinguish between "new" balance sheet assets that create (or will create) financial leverage and those that do not, being mindful that not all assets/exposures contribute to a build-up of financial leverage.

## **Numerator - Capital**

We encourage the Basel Committee to consider including Tier 2 capital in the assessment of leverage. Under Basel III, Tier 2 capital will contain the same loss-absorbing attributes as non-common Tier 1 capital, and thus, depending on the jurisdiction, will either be converted into common equity or be written off at the same time (i.e. on the cusp of bank non-viability). By expanding the capital measure to include Tier 2 capital, which is mostly purchased by institutional investors, Canadian banks would have greater access to the capital markets in order to meet a potential leverage ratio shortfall. Further, by expanding the capital measure to include Tier 2 capital, banks will be better equipped to manage their leverage by having access to a wider array of instruments in order to raise capital.

Finally, the proposed narrower capital base will make it much more likely that the leverage ratio will become the binding constraint in times of stress (i.e. CET1 is reduced by losses) - and, as the leverage ratio is risk insensitive and raising Tier 1 capital in times of stress may not be practicable or financially viable, this will require banks to de-leverage through asset dispositions and reductions in originations. Such a procyclical impact would be highly undesirable and inconsistent with the macroprudential goal of ensuring that lending to quality borrowers continues to avoid a worsening economy and a prolonged downturn. Including subordinated debt in the leverage capital base, as is the case with the assets-to-capital multiple in Canada, will provide a good alternative to de-leveraging and help mitigate the procyclical impact of the leverage ratio.

## **Three-month average**

The requirement that the proposed basis of calculation be the average of the three month-end leverage ratios is overly burdensome and not consistent with current accounting disclosure practices, which use period-end spot balances. Further, a three-month average will make reconciling the Basel III leverage ratio with the balance sheet much more difficult. While we appreciate that the rules are trying to ensure that leverage is not manipulated monthly, this additional requirement of an average of three month-end ratios places additional regulatory

burden on the production of monthly balance sheets that are not normally reported externally. Specifically, we caution that some valuations/adjustments are done only quarterly, and thus would only be reflected in the last month of the quarter. We recommend that the leverage ratio be calculated as a quarter-end spot measure.

We thank you for taking our comments into consideration and look forward to future discussions on these issues.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Girard", is positioned to the right of the "Sincerely," text.

Attachment

cc: Gilbert Ménard, Senior Director, OSFI Capital Division  
Catherine Girouard, Acting Director, Capital Division, OSFI  
Brad Shinn, Acting Managing Director, Capital Division, Regulation Sector, OSFI  
Laural Ross, Director, Special Projects, Accounting Policy, OSFI

## **CBA comments on the Basel Committee's consultative document: *Revised Basel III leverage ratio framework and disclosure requirements***

### **CBA Members' Comments and Requests for Clarification**

#### **II. DEFINITION AND MINIMUM REQUIREMENTS (Page 2)**

- [Para 7]: "... a minimum requirement of 3% for the leverage ratio..."

Increasing the requirement above 3% can have the consequence of incenting/requiring AIRB compliant banks that are focused on a low risk-weight asset strategy to increase their asset risk profile in order to consume risk-based capital equal to the required Tier 1 leverage capital. We believe that any adjustments to the 3% minimum requirement should be made at the discretion of national regulators.

Some regulators have pushed in favour of higher minimum ratio requirements. The actual Canadian leverage ratio (i.e. assets-to-capital multiple or ACM) has performed well during the last crisis. As the proposed Basel III leverage ratio is more restrictive, we believe that the regulators should avoid increasing the minimum requirement.

- [Para 6]: "*The basis of [the] calculation is the average of the three month-end leverage ratios over a quarter. (Footnote 2: Each month-end leverage ratio is calculated by dividing the month-end Capital Measure by the month-end Exposure Measure).*"

The rationale for the proposal of an average leverage ratio basis has not been made clear by the Basel Committee, although anti-avoidance could be the primary reason. The calculation on an average basis is a divergence from other capital measures that are on a period-end spot basis. It is not clear that an average methodology leads to a better measurement of the leverage constraint.

As stated in our cover letter, we believe that the additional requirement of a three month-end average is placing additional regulatory burden on the production of monthly balance sheets that are not normally reported externally. Specifically, we caution that some valuations/adjustments are done only quarterly and would thus only be reflected in the last month of the quarter. We recommend that the leverage ratio be calculated as a quarter-end spot measure.



**CBA Members' Comments and Requests for Clarification****III. CAPITAL MEASURE** *(Page 2)*

We support basing the leverage ratio on transitional capital as this is consistent with the current ACM measures used in Canada.

We believe that the capital measure should be consistent with the risk-based capital framework to facilitate optimization of capital structure (mix and quantity). It is not clear why the capital measure of the leverage ratio is restricted to Tier 1 capital only. It would be problematic to balance the capital structure across two capital requirements if the capital measures for risk-based capital rules and leverage rules are not consistent with each other. The leverage ratio requirement could become a binding constraint for banks, which may result in the banks having to raise more Tier 1 capital than is contemplated under the risk-based capital framework. This would increase the cost of the capital structure as banks are not able to use the lower cost Tier 2 capital to supplement leverage ratio requirements. Further, if the leverage ratio is inappropriately calibrated, it could make obsolete the Tier 2 instrument. We believe the use of Total capital is preferable for the leverage ratio given that banks are required to issue loss absorbing Tier 2 capital in the future for Basel III capital adequacy requirements. For leverage ratio purposes, Canadian banks currently use Total capital as the capital measure. As noted in the cover letter, a broader capital base for the leverage ratio significantly mitigates the risk that the ratio will prove to be significantly pro-cyclical and a source of forced de-leveraging that will deepen and prolong economic stress. Given the very conservative nature of the exposure measure proposed in the consultative paper (e.g. 100% of committed undrawn lines, and 10% for unconditionally cancellable commitments), we recommend that any new leverage measure continue to use Total capital to offset the conservatism in the denominator.

The uncertainty about the type of capital that will be used in the leverage ratio calculation creates difficulty in efficient capital planning. Due to Canadian banks' risk profile and uncertainty about Non-Viability Capital Conversion (NVCC) structure, we believe that the treatment for the ACM and the leverage ratio under the transition rules should be the same.

**IV. EXPOSURE MEASURE** *(Pages 2 – 8)***(i) Scope of consolidation** *(pages 2 - 3)***(ii) General measurement principles** *(pages 4 - 8)***a. On-balance sheet exposures** *(page 4)*

**CBA Members' Comments and Requests for Clarification****b. Derivative exposures** (pages 4 - 6)

As regulators and banks have acknowledged, the Current Exposure Method (CEM) is a rudimentary, one-dimensional measurement method that has fundamental weaknesses. In particular, the potential future exposure (PFE) measure under CEM only partially recognizes the exposure-reducing effects of offsetting positions, even where the transaction is subject to a legally enforceable netting agreement. The CEM also fails to recognize the exposure-reducing effects of very high-quality collateral, including collateral that takes the form of riskless cash. Further, the CEM fails to recognize other risk-reducing measures such as collecting daily variation margin, applying haircuts to non-cash collateral, and diversifying the risk of a derivatives portfolio—all of which are well accepted risk management practices for limiting actual derivatives exposure.

The criticisms of the CEM approach has led the Basel Committee to develop the non-internal models method (NIMM) approach that is considering to replace the CEM. The NIMM method retains the benefit of collateral and is more reflective of legal netting arrangements. When calibrating the leverage ratio, we believe that the Basel Committee should consider the outcome of the NIMM proposal for computing the counterparty credit risk exposure.

**1. Treatment of written credit derivatives (including operationalizing the treatment in para 33 and footnote 18)**

We respectfully request clarification that “written credit derivatives” in paragraphs 30 to 33 includes only written credit default swaps (CDS) and does not include Total Return Swaps. The add-on factors listed in paragraph 3 of the Annex 1 consider credit default swaps (CDS) and total return swaps (TRS) on credit instruments as credit derivatives; however, paragraphs 30 through 33 appear to only relate to written CDS.

Although the counterparty credit exposure from the fair value of a credit derivative contract is already reflected in the Leverage Exposure Measure through the requirements for financial derivatives, the paper explains that additional requirements are necessary for a written credit derivative as its notional credit exposure to the credit instrument of the reference entity is not reflected on-balance sheet.

In addition, the netting provisions allowing the netting of CDS purchased against the exposures of CDS as written (subject to criteria) are welcome. Similarly, however, a CDS purchased may mitigate similar risks with respect to long cash positions in debt instruments through the term of the purchased protection. We recommend that the requirements for credit derivatives include permissible netting across netting sets for (1) purchased CDS that hedge long-cash positions, and (2) TRS swap notionals where the bank pays the return on debt instrument assets (i.e. long-cash positions that it holds on-balance sheet) when the criteria of paragraph 31 and footnote 17 are met. Netting should be permitted in cases in which the bank is long the reference debt instruments and short the matching swap since the economics are the same as netting a purchased vs. written CDS and the

**CBA Members' Comments and Requests for Clarification**

bank is only subject to counterparty credit risk, which is incorporated through the derivatives treatment.

## 2. Treatment of derivatives collateral (see para 28, footnote 15)

We understand and support reporting requirements that 'level the playing field' in terms of accounting regime differences; however, we do not view the gross reporting of derivatives and the associated cash collateral (which aligns with the IFRS accounting presentation) within the leverage ratio calculation as appropriate. For derivative transactions, we view the netting that is permitted under the Basel II Framework as reflective of our true exposure for the purposes of the leverage ratio. By disallowing the recognition of any accounting netting and the permitted Basel II Framework netting, we are normalizing the balance sheet assets across accounting jurisdictions, but we are normalizing the assets to a gross amount that does not reflect an appropriate exposure for leverage.

In addition, we note that there is accounting netting that occurs for certain derivative transactions across accounting regimes, which may unintentionally be caught within the scope of the prohibited netting under the consultative document as it is currently drafted (paragraphs 28 and 35 (i)). Specifically, "accounting netting" is generally achieved through the use of central clearing counterparties (QCCPs), and it is not clear whether the provisions within the consultative document are meant only to address the 'level-playing field issues' with regard to differences in accounting standards, or if the intention is to unwind all accounting netting, including the netting achieved through the use of QCCPs regardless of the applicable accounting framework.

The lack of recognition for collateral may be driven by concerns arising from the re-use or re-hypothecation of collateral received in a derivatives transaction. While such concerns can be valid, the leverage ratio is a blunt, indirect, and inappropriate tool for addressing them, especially in light of its unintended consequences. Instead, any such concerns should be addressed directly with much more targeted regulatory measures, such as regulatory developments that require contracts be cleared through QCCPs. In a derivative transaction that is cleared through a QCCP, the variation margin generally extinguishes the marked-to-market liability. As such, the correct measurement of exposure is best reflected by considering only the initial margin and default funds. We believe that collateral treatment should be differentiated for Qualifying CCP's given the robust initial and variation margin requirements that centrally-cleared transactions follow compared to other bilaterally executed over-the-counter (OTC) derivative contracts.

### c. Securities financing transaction (SFT) exposures (page 7)

**CBA Members' Comments and Requests for Clarification****3. Treatment of SFTs (see para 34 – 39);**

Similar to the concerns raised above, we note that the consultative document requires leverage ratio gross-up adjustments to balance sheet items so that certain assets are reported “*with no recognition of accounting netting*” (paragraph 35 (i)). We understand and support reporting requirements that promote a level the playing field in terms of accounting regime differences; however, we do not view the gross reporting of Securities Financial Transactions (SFTs) within the leverage ratio calculation as appropriate. Similar to derivatives, we view the netting that is permitted under the Basel II Framework for SFT transactions as appropriate and reflective of our true exposure for the purposes of the leverage ratio.

In addition, we note that there is accounting netting achieved through the use of CCPs for certain repo transactions in Canada that may unintentionally be caught within the scope of the prohibited netting under the consultative document. Therefore, we request clarification on whether CCP transactions are within the scope of paragraph 35 (i).

The Basel Committee's rationale for penalising SFTs by including a measure of counterparty credit risk (see paragraph 35(ii)), in addition to the gross SFT recognized on balance sheet, is unclear and may negatively impact the SFT market. This treatment requires more leverage than uncollateralized loans, which does not seem appropriate given the relative security of the two instruments.

The gross measure of SFT assets is overly punitive because it fails to recognize the netting of payables and receivables under a legally enforceable netting agreement, even where the transactions are between the same counterparties, have explicit end dates, and are secured by riskless cash collateral or low-risk sovereign bonds. Although the proposed new treatment would certainly achieve one of the Committee's stated goals to adopt a standard for SFTs that would apply uniformly in all jurisdictions, it would do so at the expense of substantially overstating banks' actual exposure amounts, and potentially causing serious problems in important financial markets.

We support the application of regulatory netting instead of the no-netting approach for repo-style transactions in the leverage ratio. The use of appropriate haircuts in an exposure calculation that incorporates netting where there is legal certainty provides a measure of exposure that is better aligned with the economic risk of repo style transactions. We agree that repo style transactions play a key role in funding. We therefore believe it is the disappearance of that funding channel in stressed market conditions that presents the real risk for repo style transactions and not any leverage opportunities they provide, and note that the funding risk is already captured in the proposed Basel Committee liquidity framework.

**CBA Members' Comments and Requests for Clarification****d. Other off-balance sheet exposures (page 8)**

The leverage ratio requires 100% of committed undrawn lines to be included as assets in the leverage calculation. Including commitments at 100% of their notional amount is an unduly conservative approach for an item that is both contingent in nature and required to be conservatively defeased with unencumbered high quality liquid assets (HQLAs). The consultative document's prescribed treatment implies an unreasonable assumption that 100% of all lines would be drawn for their full amount. Moreover, the 100% draw assumption is proposed despite no historical evidence leading up to, during, or after the financial crisis, in support of a framework that assumes that every single bank customer will completely draw any remaining commitment regardless of need, economic environment, or cost. We agree that, due to the contingent nature of committed lines, there is a potential for an exposure arising in the future that could contribute to a bank's leverage. Consequently, we support a leverage framework that takes into consideration a reasonably conservative estimate of the exposure that could possibly contribute to a bank's leverage (but we do not support a framework that assumes 100% draw for 100% of the undrawn commitment amounts, particularly in light of the interaction of the proposed leverage ratio with other BIS III requirements, including the Liquidity Coverage Ratio and the Net Stable Funding Ratio). In this regard, we believe that the manner in which the Basel Committee has proposed to capture the exposure associated with committed undrawn lines is unnecessarily and overly conservative. Moreover, the current proposal fails to recognize that banks will be conservatively defeasing and capitalizing the contingent exposure associated with committed lines due to other regulatory requirements.

Each bank will be required to set aside unencumbered HQLA related to the unutilized portion of each and every committed line that it has extended. All of these unencumbered HQLAs will show up on the banks' balance sheets and will be explicitly captured in their leverage ratio. We believe that the required amount of unencumbered HQLA (these requirements have been calibrated to the amount of exposure that is conservatively estimated to occur in the future) establishes the appropriate exposure measure for committed lines. Furthermore, regulators can take comfort in the fact that, in addition to the regulatory capital required for the unencumbered HQLA and required leverage ratio capital for these assets, the full amount of the committed line is subject to an additive regulatory capital requirement.

The current proposed treatment for committed lines seems likely to constrain the overall ability of the system to provide committed back-up lines. If not addressed, banks will be faced with very difficult decisions in terms of providing committed lines to both its retail and corporate clients. To address the cost and required funding associated with the proposed treatment, banks will have to decide whether to pass on the incremental costs, ask its shareholders to subsidize the cost, reduce availability, or potentially re-engineer the product in potentially unpredictable ways. It is not unreasonable to predict that banks choose to pursue the first course of action. This can be expected to drive the cost of back-up lines (to our customers) higher. If implemented, this will result in banks becoming more conservative in approving lending proposals. This is contrary to what governments are looking to banks for - to lend to kick start the economy.

**CBA Members' Comments and Requests for Clarification**

The following explains the economic backdrop and concerns related to the current proposed treatment of committed lines.

We reiterate our concern on securitization conduit/ABCP conduit liquidity lines included in paragraph 40 at 100% credit conversion, that the following needs to be netted out:

- Any related liquid asset holdings either:
  - required under new Basel liquidity proposals due to maturity of ABCP supported by the liquidity lines, or
  - currently held in relation to the liquidity commitments under existing bank liquidity management policies.

While off-balance sheet commitments are a source of leverage in the future due to borrowers' potential draw down, applying a 100% credit conversion factor (CCF) to undrawn committed facilities implies that all these commitments will be drawn simultaneously without exception. This ignores the business reality that banks could refuse funding based on the terms and covenants of the credit facilities. The proposed 100% CCF is overly conservative and is not in line with the 50% CCF permitted under the standardized approach, which reflects the reality that the drawdown of commitments is subject to terms and conditions of the credit arrangement.

In addition, and similar to the commitments described above, other off-balance sheet items such as direct credit substitutes, acceptances, standby letters of credit, etc. will be double counted in the leverage ratio, to the degree where national supervisor can determine whether, and to what extent, these contingents outflows are to be included in the LCR. This "national discretion" will promote uneven-playing field, and might even force financial institutions in jurisdictions where the capital burden in leverage is double counted to exit the market, unable to compete. As supervisors try to move away from LIBOR, instruments (e.g. bankers' acceptances) offer a certain appeal, but double counting in the leverage ratio makes it virtually certain that it will not be adopted in a wide-scale way.

Below is a spreadsheet with a high-level analysis on the cost of undrawn commitments versus a drawn credit. We believe it illustrates that a higher leverage ratio target may have the unintended consequence of reducing retail and wholesale lending. The spreadsheet considers the regulatory cost of a leverage ratio calculated at 0%, 3% and 6% of the commitment amount across various rating assumptions. Calculations are performed using the standardized and advanced approaches.

The spreadsheet also displays calculations that seek to reflect the manner in which the proposed Tier 1 capitalization for undrawn commitments already imposes significant capital requirements on these positions. For example, under the standardized approach for undrawn AAA commitments, the required Tier 1 capital for a \$100M commitment (ignoring leverage ratio) is already equivalent to the capital required for a \$95.60M commitment assuming a 3% leverage ratio.

### CBA Members' Comments and Requests for Clarification

In addition, the spread sheet shows effective exposure amount of an off-balance sheet commitment would be even greater than 100 percent given the LCR requirements. That is, the LCR requires a bank to hold unencumbered cash or other HQLA to cover the total net cash outflows over a 30-day period under a stress scenario. Off-balance sheet commitments must be included in the total net-cash outflows according to drawdown percentages, and a bank must hold sufficient cash or other HQLA for such commitments to meet the LCR. Such cash or other HQLA will in turn be added to the exposure measure in addition to the 100 percent CCF for off-balance sheet commitments. As a result, the exposure measure for an off-balance sheet commitment effectively would be greater than 100 percent for purposes of the leverage ratio. This result is both perverse and economically incorrect.

Impact of Leverage Ratio on Basel Capital for Corporate Exposures													
Standardized Approach													
Undrawn Commitment													
						Regulatory Cost (bps)							
Credit Assessment	Risk Weights	Tier 1 Capital %	Capital	Leverage Ratio	Greater of	Cost of Capital	w/o Leverage	3% Leverage	6% Leverage	LCR Outflow Multiplier	HQLA for LCR on B/S	Effective on B/S for 3% Leverage	Effective on B/S for 6% Leverage
AAA to AA-	20%	10%	2%	6%	6%	15%	30	45	90	10%	8.7%	95.6%	47.8%
A+ to A-	50%	10%	5%	6%	6%	15%	75	75	90	10%	5.4%	184.7%	92.4%
BBB+ to BB-	100%	10%	10%	6%	10%	15%	150	150	150	10%	0.0%	333.3%	166.7%
Below BB-	150%	10%	15%	6%	15%	15%	225	225	225	10%	0.0%	500.0%	250.0%
Unrated	100%	10%	10%	6%	10%	15%	150	150	150	10%	0.0%	333.3%	166.7%

## CBA Members' Comments and Requests for Clarification

Advanced Approach																	
Undrawn 1 yr Commitment									Regulatory Cost (bps)								
				Risk	Tier 1		Leverage		Cost of	w/o	3%		LCR Outflow	HQLA for	Effective on	Effective on	
	PD	LGD	EAD	Weights	Capital %	Capital	Ratio	Greater of	Capital	Leverage	Leverage	6% Leverage	Multiplier	LCR on B/S	B/S for 3% Leverage	B/S for 6% Leverage	
AAA	0.03%	45%	75%	5.68%	10%	0.57%	6%	6.0%	15%	9	45	90	10%	10.2%	53.0%	26.5%	
AA+	0.03%	45%	75%	5.68%	10%	0.57%	6%	6.0%	15%	9	45	90	10%	10.2%	53.0%	26.5%	
AA	0.03%	45%	75%	5.68%	10%	0.57%	6%	6.0%	15%	9	45	90	10%	10.2%	53.0%	26.5%	
AA-	0.05%	45%	75%	8.29%	10%	0.83%	6%	6.0%	15%	12	45	90	10%	9.9%	60.7%	30.4%	
A+	0.08%	45%	75%	11.67%	10%	1.17%	6%	6.0%	15%	18	45	90	10%	9.6%	70.8%	35.4%	
A	0.10%	45%	75%	14.00%	10%	1.40%	6%	6.0%	15%	21	45	90	10%	9.3%	77.7%	38.9%	
A-	0.12%	45%	75%	16.01%	10%	1.60%	6%	6.0%	15%	24	45	90	10%	9.1%	83.7%	41.8%	
BBB+	0.18%	45%	75%	20.78%	10%	2.08%	6%	6.0%	15%	31	45	90	10%	8.6%	97.9%	48.9%	
BBB	0.25%	45%	75%	25.86%	10%	2.59%	6%	6.0%	15%	39	45	90	10%	8.0%	113.0%	56.5%	
BBB-	0.41%	45%	75%	34.99%	10%	3.50%	6%	6.0%	15%	52	52	90	10%	7.0%	140.1%	70.1%	
BB+	0.78%	45%	75%	49.02%	10%	4.90%	6%	6.0%	15%	74	74	90	10%	5.5%	181.8%	90.9%	
BB	1.02%	45%	75%	55.39%	10%	5.54%	6%	6.0%	15%	83	83	90	10%	4.8%	200.7%	100.4%	
BB-	2.10%	45%	75%	73.03%	10%	7.30%	6%	7.3%	15%	110	110	110	10%	2.9%	253.2%	126.6%	
B+	3.07%	45%	75%	83.07%	10%	8.31%	6%	8.3%	15%	125	125	125	10%	1.8%	283.0%	141.5%	
B	6.48%	45%	75%	109.78%	10%	10.98%	6%	11.0%	15%	165	165	165	10%	0.0%	365.9%	183.0%	
B-	9.31%	45%	75%	127.96%	10%	12.80%	6%	12.8%	15%	192	192	192	10%	0.0%	426.5%	213.3%	
CCC	27.46%	45%	75%	176.26%	10%	17.63%	6%	17.6%	15%	264	264	264	10%	0.0%	587.5%	293.8%	



## CBA Members' Comments and Requests for Clarification

Drawn Commitment									Regulatory Cost (bps)			
	PD	LGD	EAD	Risk Weights	Tier 1 Capital %	Capital	Leverage Ratio	Greater of	Cost of Capital	w/o Leverage	3% Leverage	6% Leverage
AAA	0.03%	45%	100%	7.58%	10%	0.76%	6%	6.0%	15%	11	45	90
AA+	0.03%	45%	100%	7.58%	10%	0.76%	6%	6.0%	15%	11	45	90
AA	0.03%	45%	100%	7.58%	10%	0.76%	6%	6.0%	15%	11	45	90
AA-	0.05%	45%	100%	11.05%	10%	1.10%	6%	6.0%	15%	17	45	90
A+	0.08%	45%	100%	15.56%	10%	1.56%	6%	6.0%	15%	23	45	90
A	0.10%	45%	100%	18.67%	10%	1.87%	6%	6.0%	15%	28	45	90
A-	0.12%	45%	100%	21.34%	10%	2.13%	6%	6.0%	15%	32	45	90
BBB+	0.18%	45%	100%	27.70%	10%	2.77%	6%	6.0%	15%	42	45	90
BBB	0.25%	45%	100%	34.48%	10%	3.45%	6%	6.0%	15%	52	52	90
BBB-	0.41%	45%	100%	46.65%	10%	4.67%	6%	6.0%	15%	70	70	90
BB+	0.78%	45%	100%	65.37%	10%	6.54%	6%	6.5%	15%	98	98	98
BB	1.02%	45%	100%	73.85%	10%	7.39%	6%	7.4%	15%	111	111	111
BB-	2.10%	45%	100%	97.37%	10%	9.74%	6%	9.7%	15%	146	146	146
B+	3.07%	45%	100%	110.75%	10%	11.08%	6%	11.1%	15%	166	166	166
B	6.48%	45%	100%	146.37%	10%	14.64%	6%	14.6%	15%	220	220	220
B-	9.31%	45%	100%	170.61%	10%	17.06%	6%	17.1%	15%	256	256	256
CCC	27.46%	45%	100%	235.01%	10%	23.50%	6%	23.5%	15%	353	353	353

## V. DISCLOSURE REQUIREMENTS (Pages 8 - 14)

## (i) Implementation date, frequency and location of reporting (page 9)

As stated in our cover letter and in Section 2 above, we believe that the additional requirement of a three month-end average is placing additional regulatory burden on the production of monthly balance sheets that are not normally reported externally. Specifically, we caution that some valuations/adjustments are done only quarterly and would thus only be reflected in the last month of the quarter.

The proposed location of the disclosure requirements in the financial statements would include more disclosure on the leverage ratio than the Tier 1 capital (CET1) ratio (as of Q4/12 notwithstanding Enhanced Disclosure Task Force (EDTF) changes). Given that the leverage ratio is designed to be a back-stop measure, we feel inclusion in the supplemental package is more appropriate.

**CBA Members' Comments and Requests for Clarification**

- [Para 49]: The requirement to have both the period end and average (over the three month period) for the leverage ratio is onerous. We recommend that the disclosure of the leverage ratio should be aligned with all other Basel III disclosures, which are based on period-end balances.
- [Para 51]: We assume that providing the disclosure either in the financial statements or the supplemental financial information, which are both kept on the website, is sufficient for the on-going archiving requirement.

**(ii) Summary table, disclosure template, reconciliation and other requirements (page 10)****(iii) Summary comparison table (pages 10 - 11)****(iv) Disclosure template and explanatory table, reconciliation and other requirements (page 11 - 14)**

- [Para 57]: As per the comment above on paragraph 49 aside, we would appreciate clarity regarding what constitutes a material difference requiring explanation between the average leverage ratio for the quarter vs. the end of quarter leverage ratio.
- [Para 59]: *"Reconciliation with public financial statements"*  
We would appreciate clarification on how this requirement is different from that set out in paragraph 55. Can we use the summary table and its explanation for this purpose?
- [Para 63]: *"...to ensure that the summary comparison tables, common disclosure template and explanatory table ...remain comparable across jurisdictions there should be no adjustments..."*  
As noted above in Section III, Capital Measure, we support basing the leverage ratio on transitional capital.

4. Calculation of the leverage ratio using the average of the three month-end leverage ratios (using the month-end capital measure and month-end exposure measure) (see para 6 & para 61, Figure 3, line 21). What are banks' views on operationalizing this requirement?

Performing this analysis on a monthly basis commencing November 2014 (i.e. first month of January 2015 quarter) would be difficult for some banks.

**CBA Members' Comments and Requests for Clarification**

Also, as highlighted above regarding the difficulty and the unclear rationale for a three-month average calculation, we would support regulation on a quarter-end spot basis.

**VI. TRANSITIONAL ARRANGEMENTS** *(Page 14)*

Under the updated global systemically important banks (G-SIB) framework, banks with a leverage ratio exposure measure exceeding EUR 200 billion will be required by national regulators to publicly disclose the 12 indicator values, including the Basel III leverage ratio exposure measure, on an annual basis, beginning four months after their 2013 financial year-end. As most banks already disclose the capital (numerator) under Basel III requirements, banks that are subject to the G-SIB disclosure requirements will effectively be disclosing the leverage ratio one year in advance of the leverage ratio disclosure requirements (i.e. Q1 2015). As a result, banks subject to the G-SIB disclosure requirements may be required to disclose their Basel III leverage ratio exposure measure based on the June 2013 consultative document and not on a final rules text. Although we understand that this issue will be considered by the Basel Committee, we wish to reinforce that the disclosure of leverage ratio exposures in 2014 will create international comparability challenges, including the potential that exposure calculations are based on different rules text. We recommend that the timing of leverage ratio disclosures be subject to the finalization of leverage ratio requirements, to ensure comparability for readers of these disclosures.

[Para 65 in relation to Para 23 (derivative exposures)]: Given that the approach makes reference to the Current Exposure Method (CEM), and the committee is considering alternatives to the CEM, such as the NIMM for capitalizing counterparty credit risk exposures, shouldn't the tools used in the "supervisory monitoring period" (aka quantitative impact study or QIS) incorporate this alternative to evaluate the impact this measure in the leverage ratio and thus arrive at a better calibration?

**ANNEX 1 REFERENCES** *(Pages 15 - 19)*

- (i) Derivative exposures** *(pages 15 - 18)*
- (ii) Securities financing transaction (SFT) exposures** *(page 18)*
- (iii) Examples of other off-balance sheet exposures** *(pages 18 - 19)*

### **CBA Members' Comments and Requests for Clarification**

More guidance is required here on specific items such as forward asset purchases:

- Do these refer to derivative forward contracts?
- Agreements to purchase a portfolio of loans at a future date?
- Other?

Some of these forward purchases might be purchased with cash and therefore would not create additional leverage, so inclusion may not be appropriate in some circumstances.