

Secretariat of the Basel Committee on
Banking Supervision

Bank for International Settlements
CH-4002 Basel
Switzerland

By email: baselcommittee@bis.org

Zurich, 20 September 2013

Re: Revised Basel III leverage ratio framework and disclosure requirements

Dear Sir/Madam,

UBS would like to thank the Basel Committee for the opportunity to respond to the consultative document on the "Revised Basel III leverage ratio framework and disclosure requirements."

We would be happy to discuss with you in further detail any comments you may have.

Please do not hesitate to contact Basil Ackermann on +41 44 239 3707 or at basil.ackermann@ubs.com if you have any questions.

Yours sincerely

UBS AG



Tom Naratil
Group CFO



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1. Introduction

UBS would like to thank the Basel Committee on Banking Supervision ("BCBS") for the opportunity to comment on its consultation paper "Revised Basel III leverage ratio framework and disclosure requirements." Please find below our response to the, from a UBS perspective, most important aspects set out in the paper. UBS also supports the comments made by the Global Financial Markets Association, the American Bankers Association, the Institute of International Finance and other trade associations.

UBS is committed to the goal of improving the stability of the financial system and we recognize that the crisis has revealed some limitations of the risk-based approach in specific areas where risks were not correctly reflected. We are fully supportive of the efforts of the BCBS to improve the system and would like to emphasize that much progress has already been made. In particular, the Basel III framework is a major step forward and should be consistently and timely implemented globally as a matter of priority.

The leverage ratio is an essential part of the Basel III framework. We support the BCBS's stated objectives of implementing a leverage ratio that can be consistently implemented and is not influenced by any particular accounting standard.

Furthermore, UBS strongly supports the work of the BCBS to monitor and ensure the consistent implementation of Basel III. We believe that these efforts should continue and also include the calculation and disclosure of the leverage ratio. Improving the consistency and comparability of the capital framework also includes a single, consistent measure of the leverage ratio in all jurisdictions, as well as homogeneous disclosures by banks.

2. Sound principles for a simple, transparent and non-risk based leverage ratio framework [par. 2]

UBS agrees with the objective to develop a "simple, transparent and non-risk based" leverage ratio framework. However, the consultation paper does, in our view, not yet meet these objectives.

	<i>Objectives</i>	<i>Observations</i>
I.	Simple	<ul style="list-style-type: none"> The proposed leverage ratio is indeed simpler than the risk based capital framework. However, due to the selective, product specific requirements, the consultation paper, presents itself as a complex rules based approach with a lack of consistency between product types and a need for further rules-based guidance. <i>We believe establishing a set of sound principles would provide a better basis for the framework.</i>
II.	Transparent	<ul style="list-style-type: none"> The consultation paper does not specify what exactly constitutes leverage. While the rules are quite prescriptive, they do not cover all questions. Furthermore, we believe that the comparability between banks is limited, due to the simplicity of the approach. Banks with the same leverage ratio are not necessarily equally leveraged. <i>The limitations relating to comparability should be addressed in the disclosures.</i>

III.	Non-risk based	<ul style="list-style-type: none"> The objective for the framework to be “non-risk based,” has only been partially achieved. The proposals contain several prudential adjustments which are risk based (e.g.: potential future credit exposure add-on for derivatives (par. 22), as well as a counterparty risk add-on for securities financing transactions (SFTs), in par. 35). However, we believe a degree of risk consideration is appropriate. Leverage itself is a risk, therefore taking certain risk aspects into account should be permissible, especially if done with a view to better measuring leverage. <i>A certain consideration of risk will make banks more comparable and the leverage ratio more meaningful. We recommend extending the scope of risk consideration.</i>
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We would like to offer the following principles, to which we make overarching observations with regard the consultation paper:

	<i>Sound principles</i>	<i>Observations</i>
I.	Scope / definition of leverage	<ul style="list-style-type: none"> The framework should have a clear definition of what constitutes leverage. <i>A definition of leverage would allow a more principles-based approach.</i> Accounting exposure measures, which do not contribute to leverage should be excluded by reference to such a definition. A definition should be consistent with the objectives of the framework, i.e., to capture exposures which may destabilize the financial system and the economy, when there is a deleveraging process” (par. 2).
II.	Consistency	<ul style="list-style-type: none"> The Exposure Measure calculation is not consistent across product types. Netting of positive and negative replacement values of derivatives, which are subject to an enforceable, capital requirement conforming netting agreement is accepted in the general derivatives approach (par. 25). In the case of SFTs, however, such netting is not considered appropriate (par. 35(i)), due to accounting differences. Accounting differences are not an appropriate reason to ignore the existence of eligible netting agreements (footnote 20). Also, treating credit derivatives like general derivatives on the one hand, but like cash instruments on the other creates inconsistencies with other derivatives as well as cash instruments as well as double counts (par. 33). We believe this is an unnecessary and difficult to understand complication. <i>Consistency is improved if the same offsetting principles apply across products and if all derivatives are treated in a consistent manner.</i>

III.	Setting appropriate incentives	<ul style="list-style-type: none"> • The proposed Exposure Measure calculation may cause banks to reduce their liquidity reserves to the minimum regulatory requirements in order to alleviate the Leverage Ratio Exposure Measure. These liquidity reserves, however, protect banks against the negative effects of deleveraging. This encourages banks to hold riskier and less liquid assets. • The lack of specific treatment for cleared OTC derivatives and exchange traded derivatives is counterintuitive to the general direction of the regulation which aims to incentivize central clearing.
IV.	Not binding in the normal course of business	<ul style="list-style-type: none"> • We support the objective stated in the consultation paper, that the leverage ratio shall be a “backstop measure”, i.e., not binding in normal circumstances. • Certain components of the framework will increase the Exposure Measure significantly (especially SFTs and credit derivatives) and it is therefore possible that the leverage ratio may become a binding constraint. This issue should be addressed through refinement of the Exposure Measure calculation and not through the leverage ratio calibration. • There are certain fundamental issues with the Exposure Measure calculation, as in some cases the Exposure Measure which exceeds the maximum potential loss that can be experienced (e.g. SFTs, credit derivatives). This unnecessarily increases the leverage ratio Exposure Measure.

3. Specific comments on the consultation paper

3.1 Definition, minimum requirement and capital measure [par. 6 - 9]

The consultation paper defines the basis of calculation as “the average of the three month-end leverage ratios over a quarter” (par. 6). This means that both the Exposure Measure and the Capital Measure form part of the averaging. ***We recommend that the quarter-end Capital Measure is used for the calculation*** and that only the Exposure Measure is averaged over the quarter, as this would be consistent with the capital measures disclosed in the financial statements and it would make the leverage ratio more manageable.

We support the efforts of the BCBS to continue to test the leverage ratio framework with a view to obtain the right calibration leading to the leverage ratio as a credible supplementary backstop to the risk-based framework and hence not the binding constraint. However, ***we strongly believe that a recalibration should only be undertaken once the final rules on the Exposure Measure are established while ensuring that the leverage ratio does not become the binding constraint for the majority of the banks in normal times.*** This implies that the risk-sensitive capital requirements based on the concept of risk-weighted assets should be the binding constraining factor for the normal course of business. Given the significance of the proposed changes any earlier re-calibration exercise would likely be misleading.

3.2 Specification of a broad scope of consolidation for inclusion of exposures [par. 10 – 15]

The consultation paper proposes that “assets and other exposures” of investments which are consolidated for accounting but not for capital purposes must be added back to the Exposure Measure, unless the investment in the unconsolidated entity is deducted from regulatory capital. If the investment in the unconsolidated entity is partially deducted, the “assets and other exposures” shall added back proportionately. This rule seeks to ensure that there is an alignment of the Capital Measure with the Exposure Measure (par. 10).

The consultation paper properly identifies the fact that this rule may result in double counts due to intercompany balances with unconsolidated entities, and we agree with the approach to allow an elimination of such double counts (par. 14).

We believe however that the add-back approach includes further complexities, which have not been addressed in the consultation paper, such as the following:

a) Unconsolidated entities may not contribute to leverage

The entity which is not consolidated for regulatory purposes may be holding assets at the risk of third party investors. In other words, these assets may not be a source of leverage because the risks related to these assets are borne by third party investors who have funded the purchase of these assets (example: unit linked life insurance contracts).

Where it can be demonstrated that an entity is not contributing to leverage, there should be a possibility of not adding back the assets of the deconsolidated entity to the Exposure Measure.

b) Deconsolidated entities may contribute to leverage, however the leverage is shared with minority interests

Illustrative Example 1 showing inconsistencies with the treatment of minority interests

Assumptions:

- Bank A holds 60% of Investee B and consolidates the entity for accounting but not for regulatory purposes.
- Book value of the investment is 6 and it is not deduct from Tier 1 capital.
- For simplicity it is assumed that the entire Exposure Measure is from balance sheet assets.

Simplified balance sheet of Investee B

Assets Investee B (= Exposure Measure)	40	Liabilities	30
		Equity held by the Bank A	6
		Equity held by minorities	4

As currently proposed, the framework would require the inclusion of 40 in Bank A’s Exposure Measure on the basis that the investment of 6 is not deducted from Tier 1 capital (assuming there are no intercompany double counts). However, in this case, there should also be consideration of the fact that the minority interests of 4 have not been recognized in Bank A’s capital, i.e. minority interests are excluded from the regulatory Capital Measure.

Accordingly, it should be made possible to apply a proportionate approach and only include 24 in the above example (i.e. 60% of 40). This would also follow the objective of having consistency between the Exposure Measure and the Capital Measure.

Similarly, this should apply where Investee B is consolidated for regulatory purposes to the extent that the minority interests are excluded from tier 1 capital.

The consultation paper should not only consider situations where investments are not excluded from Tier 1 capital, but also situations where minority interests are not included in Tier 1 capital.

Considering these complexities and in order to preserve the objective of having a “simple” framework, we ask whether this alignment of the Exposure Measure could be waived on the basis that ***using the regulatory scope of consolidation*** would be materially correct.

3.3 On balance sheet exposures [par. 19 – 21]

The consultation paper requires the inclusion of all on-balance sheet assets in the Exposure Measure (par 19). Therefore no incentive is provided to hold liquid assets. We disagree with this approach as to some extent, as liquid assets contribute significantly to a reduction of the risks associated with a deleveraging of the balance sheet.

Exclude cash and other high quality liquid assets from the Exposure Measure

The financial crisis underscored that some banks, despite adequately capitalized, were not sufficiently protected against liquidity risks.

While we support the leverage ratio as a backstop measure for capital adequacy purposes, we would like to strongly caution against its potential unintended consequences on liquidity buffers. The proposed rules do not make a distinction between non-risky highly-liquid assets such as cash and high-risk illiquid instruments.

Banks hold high-quality liquid assets (HQLA) as a protection against liquidity risk, resp. the risk of deleveraging liabilities; prudent liquidity buffers increase a bank’s resilience in crisis situations and improve the overall financial stability. As long as the trade-off between liquidity buffers and leverage ratio exists, bank behaviors during times of market stress could aggravate financial instability. For example, banks could be forced by market pressure to decrease liquidity buffers consisting of HQLA to artificially boost their leverage ratio, which is contrary to what bank behavior would be if this trade-off did not exist.

In order to set the appropriate incentives, there should be no trade-off between different prudential measures within the regulatory framework.

Thus, for the desired effect of improving financial stability and the resilience of the banking sector, ***we recommend excluding certain high-quality liquid assets (HQLA), in particular Level 1 assets as defined for the BCBS’s Liquidity Coverage Ratio, from the Exposure Measure of the leverage ratio. Such exclusion from the Exposure Measure should apply to all such assets held so as to set the appropriate incentives.***

3.4 Clarification of the general treatment of derivatives and related collateral [par. 22 – 29]

The consultation paper defines the **general treatment for derivatives** as the replacement cost plus an add-on, calculated under the Current Exposure Method (CEM) (par. 24). Netting is permitted for positive and negative replacement values provided there is an eligible netting agreement. Collateral received and paid cannot be used to net the accounting Exposure Measure, as this would not reduce the “economic leverage inherent in the derivative position” (par. 17 and 27).

We would like to offer the following observations regarding the general treatment of derivatives:

- We agree that positive and negative replacement values under an eligible netting agreement should be offset. However, the reasons for the prohibition of netting collateral are not clear to us, especially cash collateral, which is part of the same netting agreement as the nettable positive and negative replacement values. From an Exposure Measure perspective, we believe that offsetting positive and negative replacement values has the ***same exposure reducing qualities*** as netting positive replacement values with cash collateral received, resp. netting cash collateral paid with negative replacement values.

- We do not share the concern that cash received as collateral would represent “a resource of leverage” on the basis that cash can be on-lent (par 26). Cash received has the potential of being on lent but it has the equal potential of reducing leverage by reducing payables. The cash received is a liability (like the negative replacement value), and the cash resp. the cash on-lent would be an asset. Therefore, if the cash received is on lent, it will be part of the Exposure Measure. ***The Leverage Ratio Exposure Measure should be based on factually existing leverage and not based on the potential to increase leverage.***

Illustrative example 2 showing that cash received / on-lent is part of the exposure measure:

Positive replacement value	100	Negative Replacement Value	80
		Margin account (Cash received)	20
Cash received / On-lent (part of the LR Exposure Measure)	20		

- Also, we do not share the concern that cash provided would represent a resource of leverage (par. 28), as an outflow of cash should not increase leverage.
- ***All balance sheet components which fall under an eligible master netting agreement should be deemed an “exposure unit of account” for Leverage Ratio purposes, including margin account receivable and payable. This principle should not only be applied to derivatives but to SFTs as well.***
- Finally, we are concerned that the absence of a differentiated approach between Centrally Cleared Derivatives (CCDs) and OTC Derivatives will not align the incentives between the risk-based regulatory capital framework and the Leverage Ratio Framework. This is essential since CCDs are a stated Basel III objective and agreed by all Regulators to be a critical crisis response initiative in reducing systemic risk within the financial system.
- ***We recommend that the CEM add-on be amended to a lower weighting for CCDs in recognition of the following:***
 - CCDs are more transparent with visibility on outstanding contracts, liquidity and ownership
 - CCDs are subject to a robust margining process (including daily variation margin without thresholds and initial margin), governed and overseen by independent Central Clearing Parties (exchanges).
 - Due to this margining process, the Notionals of CCDs are far higher than the actual economic risk. Applying the same weightings as for OTC Derivatives would make the Leverage Ratio more binding, and creating the wrong incentives for market participants, e.g. to move to higher risk products.
- A lower CEM add-on weighting for CCDs is also essential to ensure that they remain economically viable for all market participants. In particular, it should be noted that the economics of centralized clearing already incorporate costs not present in the OTC Derivatives (e.g. default fund capitalization, top-up of default funds if an exchange defaults, margining infrastructure, protection of client assets). These measures all reduce systemic risk and thus need to be appropriately incentivized in the regulatory framework.
- In addition, the current consultation paper would require a clearing bank to calculate an add-on for the client leg as well as the CCP leg. Inclusion of the CCP leg would not be justified where the bank does not indemnify clients against the CCP performance and thus the margin it posts to the CCP is not at risk. It thus represents a “double count” that would act as a further disincentive for central clearing, again working against the related FSB objectives. For these reasons, we recommend that the CCP leg of CCDs be waived.
- Similarly, in certain jurisdictions (e.g., United Kingdom), clearing banks are required to safeguard excess client money at third party banks. These sums are included in the Leverage Ratio Denominator, even though FCA regulatory rules specify that clearing banks will not indemnify clients against loss from failure of one or more of these third party banks. ***We therefore recommend that Excess Client Money held under such arrangements be excluded from the Leverage Ratio calculations.***

3.5 Written credit derivatives [par. 30 – 33]

The consultation paper defines the Exposure Measure for credit derivatives as the sum of the general treatment for derivatives (section 3.4) plus an additional treatment (par 31):

- full effective notional value referenced by a written credit derivative is to be incorporated into the Exposure Measure;
 - I. the effective notional amount of a written credit derivative can only be reduced by the effective notional amount of a purchased credit derivative on the **same reference name** and level of **seniority**, if the remaining **maturity** of the purchased credit derivative is equal to or greater than the remaining maturity of the written credit derivative.

We would like to offer the following observations regarding the treatment of written credit derivatives:

- The consultation paper contains a stated objective of treating written credit derivatives like cash instruments, e.g. loans or bonds (par. 30). Yet, it then actually does not treat cash instruments in the same way as credit derivatives when the exposures are hedged (par. 32). We do not understand why unhedged credit derivatives should be treated cash instruments, but when the position is hedged, credit derivatives are still considered to be different from cash instruments. This approach creates inconsistencies, which could be extended to situations where guarantees are hedged by credit derivatives. ***These inconsistencies should be resolved by using the general derivative treatment for all derivatives, including credit derivatives.***
- We consider the maturity matching condition to be too strict, considering the fact that a credit event would cause credit derivatives of all maturities to be triggered.
- Furthermore, the proposed approach seems has several inconsistencies.

Illustrative example 3 highlighting some of the inconsistencies of the proposed approach

A written credit derivative of 100 with a negative replacement value of 8 would be treated as follows:

General derivative treatment: Add on of 10% of 100 = 10
Special treatment: Notional amount of 100
Total Exposure Measure: $110 - 10 = 100$ (10 could be deducted based on par. 33, to avoid double counting)
A forward purchase of a loan of 100 would only receive a general derivative treatment, i.e. the notional amount would not be included in the exposure measure.

- Furthermore, the Exposure Measure in the example is too conservative as ***the maximum possible loss on credit derivative of 100, of which unrealized losses of 8 have already been booked is 92. The Exposure Measure should not exceed the "bond equivalent" amount.***

We believe that these inconsistencies can be avoided by applying only the general derivatives treatment to written credit derivatives.

3.6 Enhanced Treatment of Securities Financing Transactions (SFTs) [par. 34 – 39]

The consultation paper for a bank acting as principal defines the Exposure Measure as Gross SFT assets recognized for accounting purposes plus a measure of counterparty credit risk calculated as current exposure (par. 35). The recognition of the gross, rather than net values of SFT assets is a major change and a source of concern. We do not understand why netting should be possible for derivatives, but not for the balance sheet components of SFTs, even though SFTs are also transacted under capital eligible netting agreements. The removal of accounting differences is not a proper justification, as for derivatives, significant accounting differences also exist, and here MNAs are considered when netting positive and negative replacement values. Oddly, when calculating the SFT counterparty exposure measure, netting agreements can be taken into account. The prohibition seems limited to the balance sheet legs of SFTs. It is unnecessary to view one leg of an SFT as the exposure and the other leg as the collateral. Both legs can be viewed as collateralizing one another, and can be closed out upon default.

All balance sheet components which fall under an eligible master netting agreement should be deemed an “exposure unit of account” for Leverage Ratio purposes. This principle should not only be applied to derivatives but to SFTs as well.

We believe that in some instances, the proposed measures contain double counts and in some cases in a total Exposure Measure which exceeds the maximum potential loss for a bank.

Illustrative Example 4a showing double counting when Bank A enters into a repo with Bank B

Bank A receives 90 repo financing from Bank B and provides security collateral of 100. The securities are part of Bank A’s trading book and remain on Bank A’s IFRS balance sheet.

Calculation of exposure measure according to the consultation paper (bank acting as principal):

<i>Bank A</i>	<i>Bank B</i>
Accounting exposure (Paragraph 35 (i)): Security collateral 100	Accounting exposure (Paragraph 35(i)): Reverse Repo 90
Counterparty risk (Paragraph 35 (ii)): Max (0; Security provided 100 – cash received 90) = 10	Counterparty risk (Paragraph 35 (ii)): Max (0; Cash provided 90 – Security received 100) = 0
Total exposure measure 110	Total exposure measure 90

We would like to offer the following observations related to this case:

- The total Exposure Measure of 110 for Bank A even exceeds the maximum potential loss that Bank A can have of 100, which would result from not receiving back the collateral provided of 100. As the collateral is still part of the Exposure Measure, there is no reason to add anything for counterparty risk. In other words, when proprietary securities are provided as collateral there is a double count of exposures.
- Not only is there a double count of exposures relating to the collateral, but there is also a systemic double count in that a financing transaction of 90 results in a total leverage ratio Exposure Measure of 190 (as the collateral is still part of Bank’s A Exposure Measure and the cash receivable is part of Bank B’s Exposure Measure).

Illustrative Example 4b showing double counting when Bank A enters into a repo with Bank B

Example 4b builds on example 4a above. Bank A receives 90 repo financing from Bank B and provides security collateral of 100. The securities are part of Bank A’s trading book and remain on Bank A’s IFRS balance sheet. Assume the value of the security subsequently drops heavily to say 50.

Calculation of exposure measure according to the consultation paper (bank acting as principal):

<i>Bank A</i>	<i>Bank B</i>
Accounting exposure (Paragraph 35 (i)): Security collateral 50	Accounting exposure (Paragraph 35(i)): Reverse Repo 90
Counterparty risk (Paragraph 35 (ii)): Max (0; Security provided 50 – cash received 90) = 0	Counterparty risk (Paragraph 35 (ii)): Max (0; Cash provided 90 – Security received 50) = 40
Total exposure measure 50	Total exposure measure 130

- The way we understand the regulation in par. 35 to work is that Bank B would have an Exposure Measure of 130, after adding the counterparty risk measure of 40 to the accounting exposure measure of 90. Bank B however cannot lose more than the accounting measure of 90, even if the security received becomes worthless. ***We do not support the accounting exposure as an Exposure Measure for SFT, but if such approach is taken, the framework must incorporate provisions which allow for the removal of double counts (similar to the concept presented in par. 33 for Credit Derivatives).***

Further SFT related comments:

- Paragraph 35 (i) refers to the removal of the value of securities “received” in an SFT, where it is recognized as an asset by the transferor. This rule is unclear and impractical. The receiver is the transferee of securities, and the transferee would need to verify whether the transferor still has the securities on the balance sheet. It would be clearer if the transferee has recognized the securities on the balance sheet, not the transferor.
- Paragraph 39 allows an economic view for the quantification of SFT risks, where the bank acts as an agent who provides a guarantee to the customer for the difference between the cash leg and the security leg of the SFT. The same economic view would apply to proprietary transaction, yet such netting is not foreseen. This significantly and unnecessarily inflates the leverage ratio denominator.
- Similar double counts would occur when multiple SFTs are transacted with the same counterparty.

Illustrative Example 5: Bank A borrows securities from Bank B and provides non cash collateral

Bank A borrows 90 of securities from Bank B and provides security collateral of 100. Both banks have borrowed the securities which they have exchanged.

Calculation of exposure measure according to the consultation paper (bank acting as principal):

<i>Bank A</i>	<i>Bank B</i>
Accounting exposure (Paragraph 35 (i)): N/A	Accounting exposure (Paragraph 35(i)): N/A
Counterparty risk (Paragraph 35 (ii)): Max (0; Security provided 100 – Security received 90) = 10	Counterparty risk (Paragraph 35 (ii)): Max (0; Security provided 90 – security received 100) = 0
Total exposure measure 10	Total exposure measure 0

We would like to offer the following observations related to this case:

- It is unclear what treatment is applicable for the borrowing and lending of securities with non-cash collateral. The consultation paper does not seem to make that differentiation.
- When applying the formula for banks acting as principal, there is no accounting exposure (Paragraph 35 (i)), and the counterparty risk (Paragraph 35 (ii)) reflects the economic exposure, assuming the transactions are conducted under an MNA.
- Where a bank is acting as an agent however (Paragraph 38 and Paragraph 39), such treatment is limited to situations where a guarantee for difference contract has been entered into with the customer.
- The absence of a guarantee for difference contract does not make the transaction “economically” riskier than when the bank acts as a principal.
- The SFT business operates with margins which reflect the economic exposure. Using the accounting measure of exposure and overlaying add-ons leads to a significant overstatement of economic exposure.
- Finally, in the case of forward starting SFTs, we believe the leverage ratio should offer the ability to exclude these from the leverage ratio Exposure Measure, where the exposure is effectively an extension of an existing SFT which is already included in the Exposure Measure (this should also apply to loan commitments, which economically extend maturing loans). Otherwise the same exposure is counted twice.

Impact of the consultation paper on the repo market

Market analysis suggests that, as currently designed, the leverage framework would potentially have a strong negative impact on the repo market. In particular, a dominant leverage ratio would have a number of perverse incentives for banks, such as favoring the reduction of low risk asset holdings, including the repo books, in order to manage to the leverage targets. Banks would be encouraged to spend available balance sheet in riskier assets in order to generate the required returns. This would lead to impaired liquidity and higher yields in primary markets as a result of reduced secondary and financing market liquidity. For many banks, the repo volume is driven by client facilitation and client market making services. This market making activity is elastic, and as this business becomes more capital intensive, banks will choose either to exit this service or to charge significantly higher prices to meet hurdle rates for the increased capital consumption. Internal analysis suggests a likely unprecedented widening in bid / offer spreads for government repo markets.

3.7 Disclosure requirements [par 43 – 63]

The consultation paper provides common templates according to which banks will be required to publish their leverage ratio. One table shows a summary comparison of the accounting assets and the leverage ratio Exposure Measure, another table shows a detailed breakdown of the leverage ratio components. Banks are not permitted to add, delete or change the definitions of any rows (par. 63).

UBS is strongly supportive of initiatives to provide more transparency through enhanced disclosures. *We agree with the use of disclosure templates for the main components of the leverage ratio to enhance comparability between banks.* As a member of the Enhanced Disclosure Task Force, we prefer voluntary development of disclosure at a more granular level. This enables disclosure to be more flexible to specific facts and circumstances, including changes over time, and encourages the development of quality disclosure across the industry. We believe that entities should be encouraged to ensure that their own disclosure is meaningful to users by being reflective of their own position. The template should be used as a starting point to which additional granularity and high quality qualitative disclosure can be added and from which information can be omitted if not considered relevant to an understanding of the entity's leverage ratio.

For example, it is important that the reader of the disclosures properly understands what the leverage ratio says about the degree of leverage that a bank is exposed to. It would be helpful to present to the reader a common definition of leverage. Also, as currently drafted, we believe the ***leverage ratio is not a reliable indicator of leverage risk***, i.e., two banks with the same leverage ratio may have very different economic exposures to leverage. This needs to be understood by users, particularly if the leverage ratio became the binding constraint.

We refer to our comments in section 3.1 on the actual calculation of the leverage ratio, where we have expressed a preference for using a quarter-end Capital Measure combined with an averaged Exposure Measure. This would require a consequential alignment of the disclosure template. Further, we recommend that only the prudentially relevant Leverage Ratios are mandatorily published (line 21) and that the period end Leverage Ratio (line 20) is only published if the information is meaningful, i.e. if there is a significant difference should period end amounts be used to determine the leverage ratio.

Finally, we note that it is proposed that the Leverage Ratio disclosure requirements become effective in 2015, in advance of the detailed requirements which are only due to be completed in 2017. We are supportive of encouraging disclosure of proforma numbers as soon as the requirements are in a near final form and we have sought to do this for similar disclosures already. Provided that the basis of the disclosure is clearly articulated, this information is of value to investors.

4. Conclusion

As highlighted above, we believe that the objective of creating a “simple, transparent and non-risk based” leverage ratio framework, fulfilling a reasonable set of sound principles has only partially been achieved. ***We appreciate the fact that there is still time to make improvements to the framework before it becomes final in 2017.*** In summary, we think that in particular the following improvements to the framework would allow the fulfilling of the objectives and related sound principles.

	<i>Sound principles</i>	<i>Proposed improvements</i>
I.	Clear definition of leverage	<ul style="list-style-type: none"> • We would ask that the leverage ratio framework is built on a clear definition of what constitutes leverage.
II.	Consistency	<ul style="list-style-type: none"> • We encourage the BCBS to carefully review the netting principles and recommend applying a consistent set of netting rules across derivatives and SFTs. We believe that netting all components within a Master Netting Agreement (MNA), for both balance sheet and off balance sheet purposes, provides an unambiguous and consistent approach across all types of transactions. • We believe that all derivatives should be treated in a consistent manner and recommend applying the general treatment of derivatives to credit derivatives as well. We do not understand why credit derivatives are treated in a differentiated way and believe that the approach to offsetting positions is excessively conservative.
III.	Setting appropriate incentives	<ul style="list-style-type: none"> • We recommend excluding HQLA and in particular Level 1 assets, as defined for the BCBS’s Liquidity Coverage Ratio, from the Exposure Measure of the leverage ratio in order to obtain the desired effect of improving financial stability. • As mentioned above all components (including eligible collateral) under an eligible netting agreement should be considered in the Exposure Measure and accounted for as an “exposure unit”. • It is important to include incentives to move to central clearing in the framework, as drafted, central clearing may have a large impact on clearing banks.
IV.	Not binding in the normal course of business	<ul style="list-style-type: none"> • We recommend that any recalibration of the framework be only undertaken once the final rules for the Exposure Measure are known and ensure that the leverage does not become the binding constraint. This implies that the risk-sensitive capital requirements based on the concept of risk-weighted assets should be the key constraining factor for the majority of day-to-day business decisions in the banking sector.