Bangkok Bank

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Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel
Switzerland
e-mail : baselcommittee@bis.org

Re: Comments on the BCBS consultative document on "Revision to the Basel III leverage ratio framework" ("the CD")

Dear Secretary General Coen,

Bangkok Bank Public Company Limited ("the Bank") appreciates this opportunity to comment on the April 2016, the consultative document issued by the Basel Committee on Banking Supervision ("the Committee") : Revision to the Basel III leverage ratio framework.

The Bank is supportive of BCBS's effort to introduce and amend a leverage ratio as supplement to risk-based backstop measure. While significant progress has been achieved by banking industry across the globe in monitoring and controlling the leverage, local supervisor in relevant countries also played a vital role in monitoring and preventing unwarranted leverage build-up in their financial system. However, the current CD proposed to adopt leverage to be a more binding capital measure, will cause and force banking industry to change or amend their strategies in a significant manner. The Bank, therefore, would like to provide comments and/or recommendation for the proposed CD as follows:

General Comments

The leverage ratio is in essence meant to be a simple and non-risk-based metric. While the Bank appreciates the Committee's objective to ensure consistency with the modified risk-based capital framework, we are of the opinion that it is immature to refine or amend this leverage ratio standard. Currently, the committee is in the midst of the consultation of risk-based Standardised Approach and IRB Approach with market participants. Both papers are yet to be finalized. As a result, we would like to propose that the Committee put more effort in enhancing and stabilizing the risk-based capital ratio for the time being. As per our understanding of the original Basel III Accord, the leverage ratio was created as a backstop measure to risk-based capital ratios. Due to dramatic increase in exposure measure, the denominator of leverage ratio, certain banks will be constrained by non-risk-sensitive leverage ratio rather than risk-sensitive regulatory capital ratios. This issue is exacerbated by the fact that the committee plans to impose leverage ratio as one of Pillar 1 requirements which banks need to constantly adhere to. These two effects will stop leverage ratio from serving as the safety net measure as it was originally designed. The original intent of the Basel Accord to promote better risk management practice will be compromised. Even worse, the committee may unintentionally incentivize banks to shift to riskier assets if leverage ratio becomes prominent constraint in banks' business conduct. We urge the BCBS to reconsider and amend the proposed rules to keep the whole banking industry from reverting several decades backwards to original starting status.

Bangkok Bank Public Company Limited Registration No. 0107536000374
333 Silom Road Bangrak Bangkok 10500 Thailand Tel. (662) 230-2365 Fax (662) 230-1573 www.bangkokbank.com

We would like to emphasize our serious and material concerns on the Group of Governors and Heads of Supervision (GHOS)'s proposal to implement the leverage ratio as a Pillar 1 measure. We continue to see that leverage ratio works better under Pillar 2 which permits leverage ratio to act as a backstop safety net rather than as a more binding ratio under Pillar 1. We highly agree that addressing the current shortfall in risk-based capital standards is necessary and major review should be undertaken. However, it is deemed unnecessary to review everything all at once especially when leverage ratio is originally considered merely as a complement ratio to the core risk-based capital ratios under Pillar 1. The current outstanding Consultative Papers, including this CD proposal and previously finalized ones (which, in our opinions, put a lot of emphasis more on comparability rather than risk sensitivity and simplicity as per BCBS's objectives) can unintentionally introduce negative implications on financial products that are key for economic growth. Certain economic sectors in both developed and emerging markets still primarily rely on banks as the main source of funding. Reducing the alignment of capital and risk could negatively affect availability and price of credit to the economy. We would like to recommend BCBS to implement as a Pillar 2 measure, thus allowing National Discretion. This will permit the national supervisors to apply leverage ratio according to respective countries and suit the capital market circumstances of their jurisdictions, especially those emerging markets whose capital markets are not yet well-developed or any bank-based economies (the nations whose economy relies mainly on banks or financial institutions in raising and distributing funds into their economic systems).

The Bank would like to provide an example to demonstrate the importance of the banks' role in economic development in the country where capital market remains developing and how leverage ratio – if not carefully imposed - may hinder such process. Currently, Thailand is under the process to develop its infrastructure in various aspects to increase its competitiveness, to ensure sustainable growth of Thai economy, and to support the ASEAN Economic Community (AEC). One of the major initiatives is the Transportation infrastructure development with the total investment budget of 1.8 trillion Baht, comprising of the investment in inter-city rail network, the major upgrade of public transportation network, maritime transport development, air transport capacity enhancement and the capacity enhancement for highway network to link with key areas in the country and with neighboring countries. The government has recently approved the establishment of an infrastructure fund with the objective to reduce the burden of the government in financing the country's infrastructure development. Commercial banks will inevitably have to provide the financial support directly (by investing in infrastructure funds to take away some burden from the ministry of finance) and indirectly (by lending to the corporate sector who invests in the projects). As, these will be regarded as part of "total exposures", a substantial increase in total exposures to each individual bank is expected and a dramatic decrease in the prescribed leverage ratio is anticipated. Due to the lack of alternative sources of fund and the degree of concentration of top banks in Thailand where top 6 banks control approximately 80% of the overall system, which is similar to other countries in Asia, there will be a serious restriction on capital distributions across the economy in order for banks to absorb the impact from drastic reduction in its leverage ratio and bring the leverage ratio back to an acceptable level again. In a big picture, given Thailand's circumstances, the nature of leverage ratio will hinder the Thai economic growth in a long term. This example clearly shows how critical it is for supervisor in each jurisdiction to exercise its judgement to ensure that leverage ratio is appropriately adopted in the fashion that is well commensurate with economic landscape as well as specific banks in questions.

The leverage ratio could have a negative impact on the effectiveness of monetary policy. The binding leverage ratio would create economic incentives for banks to substantially reduce their

participation in the market for Securities Financing Transactions, SFTs. However, the central bank fundamentally relies on banks to be major counterparties and to keep liquid SFTs market to be sufficiently liquid in order to implement monetary policy and manages bank reserves.
In short, the Bank prefers to have leverage ratio adopted as part of Basel Pillar 2 to Pillar 1 and would like to propose that national supervisor defines its own leverage ratio framework to better suit its economic circumstances.

Specific Comments

Adoption of modified version of SA-CCR

Regarding revision of the Basel III leverage ratio framework focusing on counterparty credit risk (CCR) exposure of derivatives for leverage ratio, the modified version of SA-CCR does not allow "initial margin" (IM) as collateral to offset exposure in both RC and PFE add-on components, but allows only "eligible cash variation margin" (CVM) under specified conditions, set out in paragraph 25, to act as an offset to the RC component only. This obviously contradicts with the original objective of SA-CCR i.e. to distinguish derivative exposure between margined and unmargined transactions because leverage ratio recognizes only some selective qualified collaterals. The proposed modifications to the leverage ratio would apply measurement methodologies that still substantially overstate the actual economic exposure. The proposed framework would still ignore the exposure-reducing effects of financial collateral especially cash collateral received in derivatives transactions even though receipt of such collateral is recognized as "best practice" for reducing counterparty exposure, and even though the Committee itself has acknowledged the exposure reducing effects of collateral by imposing regulatory margin requirements on derivatives counterparties. This proposed treatment would compound the departure from actual economic exposure by double counting the leverage in the transaction and would disagree with accounting practices.

In addition, as modified SA-CCR is setting PFE multiplier equal to 1 (one), the PFE add-on component will recognize neither any collateral posted by counterparties nor negative net market value of the derivative positions. In case of negative net market value, PFE should normally be reduced because out-of-money transactions do not represent an exposure and have less chance to go in-the-money per paragraph 149 of the standardized approach for measuring counterparty credit risk exposures. Therefore, the Bank is of the opinion that BCBS should maintain the main spirits of SA-CCR standard. In other words, the Basel III leverage ratio framework should apply the same exposure calculation concept as that of RWA calculation, removing confusion and inconsistency when both non-risk based and risk based exposures of derivatives are referred.

Revisions to the CCF for off-balance sheet items

The Bank agrees with the use of CCF, according to 2nd revised SA, in the leverage ratio, since this is in line with the exposure calculation for both non-risk based calculation and risk based calculation. However, the Bank still considers the CCF to be too high which will impact banks' lending in general as well as the economy as a whole. This is because Thailand is still a bank-based emerging market country with a large number of SMEs and Corporates who heavily rely on banks as the major source of fund in their business conduct. BCBS should carefully consider i) lowering the CCF in the 2nd revised SA, or ii) making it subject to national discretion to allow local regulator to take banks' lending business and economic growth into consideration.

Additional requirements for G-SIBs

The Committee's original intent, also re-iterated in this CD, to impose a leverage ratio is to reinforce the risk-based requirements with a simple, non-risk-based backstop measure. The committee intends that the two measures will complement each other. The risk-based requirements are intended to be the binding constraints in order for banks to effectively and efficiently allocate and manage their capital according to the actual risks they take. On the other hand, the leverage ratio is intended to merely be a supplemental or backstop requirement. As such, the Bank strongly believes that the total capital measures are more appropriate to act as primary or main risk boundaries than simply using the Tier 1 capital in the proposed Leverage Ratio which is, by essence, meant to be a quite simple, and non-risk-based metric. Since leverage ratio is a secondary backstop by nature, we see no reason to over-engineer its usage. The total capital, Tier 1 and Tier 2, should have been taken into account. The differentiation of the two seems unnecessary. However, as this issue may be too late to re-consider at this point, the Bank's view on above queries is as follows:-

1. The Bank strongly believes that Tier 1 is considered a proper capital measure and additional Tier 1 should not be subject to any limitation. This qualification of Tier 1 capital – both CET1 and Additional Tier 1- has been rigorously reviewed by BCBS during Basel III implementation to ensure sufficient loss absorbency. In addition, during the Basel III review, the committee had already strengthened the definition of Tier 1 to ensure sufficient loss absorbency for going concerns. This resulted in more narrowly defined set of financial instruments considered as Tier 1 capital. Certain hybrid instruments were no longer considered as Tier 1 capital since they were unable to adequately absorb losses during the financial crisis. Given this backdrop, we are convinced that the characteristics of prevailing Tier 1 capital, both CET1 and Additional Tier 1, are well-defined and appropriate to be used in Capital Framework. This Tier 1 capital can properly be used in the leverage ratio calculation and there is no reason to deviate from it especially from loss absorbency perspective.
2. As the Bank has already expressed above, we are of the opinion that leverage ratio should be more appropriate as a Pillar 2 measure since Pillar 1 should serve as a primary binding constraint due to its risk sensitive nature. Therefore, G-SIBs may appropriately set leverage ratio target according to its business model and balance-sheet structure of respective central banks. Besides, G-SIBs are subject to maintain higher capital and to abide by additional rules. There is no need for additional non-risk sensitive measures like the leverage ratio.
3. Same as comments above. The risk-sensitive capital measure has already been set. The Committee should avoid rushing the implementation of additional measures. Rather, it is recommended to wait until the impacts of current measures fully flow through the economies.

For your kind consideration.

Ayuth Krishnamara
Executive Vice President
Head of Risk Management Division
Bangkok Bank PCL