

July 6, 2016

Secretariat of the Basel Committee on Banking Supervision
Bank of International Settlements
CH-4002 Basel, Switzerland
<http://www.bis.org/bcbs/commentupload.htm>

Dear Sir/Madam:

**Re: CBA comments on BCBS consultative document:
Revisions to the Basel III leverage ratio framework**

The Canadian Bankers Association (CBA)¹ is pleased to provide its comments on the Basel Committee on Banking Supervision's (BCBS) proposed revisions to the leverage ratio framework. The CBA supports the Group of Central Bank Governors and Heads of Supervision (GHOS) view that the leverage ratio should be based on a Tier 1 definition of capital and should comprise a minimum level of 3%. We also support the BCBS's efforts to create consistency in the treatment of purchases and sales of financial assets, clarify the treatment of provisions, and consolidate the leverage ratio disclosure requirements into Pillar 3.

However, despite our support for many of the proposed revisions, we are concerned that the revisions, in their entirety, could result in a material increase in leverage ratio requirements for Canadian banks. The comments on the proposed revisions that are of greatest importance to Canadian banks are detailed below, with additional comments contained in the attached appendix.

Modified SA-CCR

The CBA, in principle, supports replacing the Current Exposure Method (CEM) with the standardized approach for measuring counterparty credit risk exposures (SA-CCR) for measuring counterparty credit risk associated with derivatives, particularly in light of the well-known limitations of the CEM and the risk sensitivity benefits associated with the SA-CCR. Nevertheless, we are concerned that the proposed modified SA-CCR change would

¹ The Canadian Bankers Association works on behalf of 59 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 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.

inappropriately overstate banks' exposures for derivative transactions, as well as increase the computational burden for banks.

The exposure measure under the SA-CCR includes an alpha value (multiplier) of 1.4, which has been carried over from the Internal Model Method (IMM). The proposed revisions to the leverage ratio would include this alpha value of 1.4 in the modified SA-CCR. As the leverage ratio is intended to act as a "simple, transparent, and non-risk-based" supplementary capital measure, we do not believe it is appropriate for the SA-CCR under the leverage ratio to include an alpha value. At the very least, the 1.4 alpha should be removed for the replacement cost component of the exposure measure as the replacement cost simply reflects the non-risk-weighted value of the derivative assets.

In addition, we would like to express our concerns over the proposal to fix the potential future exposure (PFE) multiplier at 1, as this would ignore the benefit of over-collateralization and negative mark-to-market. The BCBS's final standard for SA-CCR (April 2014) states, "As a general principle, over-collateralization should reduce capital requirements for counterparty credit risk." The SA-CCR standard also states that the "multiplier will be activated when the current value of the derivative transactions is negative...because out-of-the-money transactions do not currently represent an exposure and have less chance to go in-the-money." For these reasons, we believe the PFE multiplier under the leverage ratio should be permitted to be lower than 1, consistent with the SA-CCR. We also request that the BCBS allow the collateral received in relation to client clearing activity to be taken into consideration in the determination of PFE.

Operationally, the CBA also questions the need for the leverage ratio to use a modified version of the SA-CCR, as this would require banks to run two versions of the SA-CCR and result in unnecessary operational complexity and burden. While we recognize the need to make modifications for leverage ratio purposes, we would like to suggest that the BCBS consider modifications that are easy to implement operationally and simple to reconcile to the basic version of SA-CCR. In addition, having two versions of the SA-CCR could create confusion in terms of disclosure as users compare leverage SA-CCR figures with those reported for regulatory capital purposes.

Treatment of Purchases and Sales of Financial Assets

The CBA supports the BCBS's efforts to clarify the calculation of regular-way purchases and sales of financial assets to ensure consistency across banks regardless of the accounting framework used by the bank. Of the two options contained in the consultative document, the CBA prefers Option B, which permits the offsetting of cash receivables and cash payables. Option A would reverse out netting allowed under IFRS and gross up exposures significantly for banks that apply trade date accounting today. In the case of financial asset sales, the risk associated with the receivables (i.e. that cash will not be delivered by the counterparty of the transaction to the bank to settle the transaction) is reduced to the extent that payables to the same counterparty are allowed to offset the receivables in practice. Therefore, Option A is too punitive.

In general, we support the BCBS's proposed criteria for netting under Option B. The CBA, however, is not supportive of the potential condition under Option B that "the trades are conducted by an entity that meets the definition of a market-maker". We believe that netting should be permitted regardless of whether the entity meets the definition of a market-maker.

Banks currently using IFRS settlement date accounting are required to provide disclosure of only material off-balance sheet commitments, including those related to the purchase and sale of financial assets. As such, the CBA suggests that banks using settlement date accounting

include – for leverage ratio purposes – only those off-balance sheet commitments that are disclosed in their financial statements or for regulatory capital purposes. This would ensure consistency between the leverage ratio, financial statements, and regulatory capital.

Treatment of Cash Pooling Transactions

The proposed gross up of asset balances for notional (or virtual) cash pooling on accounts that allow the combining of balances of several accounts of entities within a corporate group will have a material negative impact on many banks' leverage ratio. In addition, there would be significant resources/costs for banks to operationally reverse this type of pooling of accounts for the purposes of quantifying it for the leverage ratio.

We believe the netting criteria related to cash pooling transactions should not be based on the existence of physical transfer of funds but rather on the legal and economic substance of the agreements supporting banks' ability to settle on a net basis. The reference to physical transfer of funds in the proposal is potentially subject to different interpretations amongst banks and could result in inconsistent leverage exposure treatment when it is not warranted. Based on legal agreement between a bank and its client on cash pooling accounts, if the bank has conducted sufficient legal review to verify and has a well-founded basis that the agreement would result in a single claim or a single liability to a single legal entity of the client, these accounts should be treated on a net basis regardless of the existence of physical transfer of funds. We request that the BCBS clarify this to be the case.

Preserve 'Eligible Liquidity Facilities' and the associated 50% CCF

The CBA generally supports the alignment of CCFs with the proposed revisions to the Standardised Approach for Credit Risk (BCBS 347 – December 2014) for the purposes of the leverage ratio. However, the CBA firmly disagrees with the decision to remove from the current leverage ratio framework the ability to assign a 50% CCF to 'eligible liquidity facilities' as defined under the Basel II framework [paragraph 578]². We believe that while the term eligible liquidity facility is no longer referenced under the new Revisions to the Securitization Framework (BCBS 303 – December 2014), further consideration should still be given to the real leverage impact of these off-balance sheet facilities. The CBA suggests that the BCBS consider preserving the 50% CCF for eligible liquidity facilities based on five fundamental factors, which are explained in detail in the attached appendix.

Finally, we would like to note that all the proposed changes will likely increase the banks' leverage exposures, and the additional cost of these proposed changes would have to be explicitly factored into the costs associated with extending these important client facilities.

We would be pleased to discuss these comments further at your convenience.

Sincerely,



² BCBS International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version), 2006.

CBA Comments on BCBS Consultative Document:

Revisions to the Basel III leverage ratio framework

II.1.2 Impact assessment on the client clearing business model

- We request that the BCBS clarify the definition of multi-level client structures within the leverage ratio framework itself, as this would assist in ensuring appropriate identification and leverage treatment and reduce the need to reference other BCBS standards. The CBA proposes the following definition of multi-level client structures for the BCBS's consideration: "A multi-level client structure is one in which institutions can centrally clear either by facing a clearing member or by facing an institution which is itself a client of a clearing member or another clearing client."
- We believe that IM should be permitted to reduce the CM's PFE for the leverage ratio exposure calculation.

II.1.3 Clarification on the currency of settlement criterion associated with the eligible cash variation margin

- We do not believe that an FX haircut for cash variation margin (CVM) is appropriate given that the leverage ratio is a non-risk-based measure. Any potential FX risk from the difference in the CVM currency and the termination currency of a netting set does not lead to an increase in the leverage exposure. Analogously, the existing leverage ratio framework measures the counterparty credit risk exposure associated with securities financing transactions (SFTs) without any haircut on the securities/cash lent and the collateral received, and we believe a similar non-risk-based treatment is appropriate for the CVM as long as it is provided in the eligible currency identified in the governing MNA/CSA.

II.1.4 Revisions to the specific treatment for written credit derivatives

- With respect to the fourth bullet in paragraph 31 of the Annex on page 10, ("...the credit protection purchased through credit derivatives is otherwise subject to the same material terms as those in the corresponding written credit derivative"), the CBA believes that to reduce the derivative exposure via the effective notional of a purchased credit protection, the two derivatives should have same material terms. The CBA requests that the BCBS provide a description of these material terms. At a minimum, we would like no material difference in terms that would infer a credit event on the written protection without a corresponding event on the purchased protection.

II.4 Additional requirements for G-SIBs

- The CBA would not support a limit on Additional Tier 1 capital that could be used to satisfy any additional requirement for G-SIBs. We believe the common equity tier 1 requirements that exist through the risk-based capital regime are sufficient and that the leverage ratio should continue to use the Tier 1 capital measure for any additional requirement for G-SIBs.
- The CBA also believes that any additional requirement for G-SIBs should be in the form of a buffer requirement (not a higher minimum requirement).

- We would like to suggest that the BCBS allow for an appropriate phase-in period for any additional capital requirement for G-SIBs.

III.1 Revisions to the credit conversion factors for off-balance sheet items

- While we understand the BCBS's rationale for incorporating the credit conversion factors (CCFs) that are ultimately implemented into the revised standardized approach for credit risk into the leverage ratio framework, we would like to reiterate the concerns raised by the CBA over these CCFs in the CBA's response to this BCBS consultative document. In particular, we believe that the higher range of CCFs for certain items, such as commitments regardless of maturity, note issuance facilities/revolving underwriting facilities, and unconditionally cancellable retail commitments, are too conservative and would inappropriately and negatively impact banks' leverage ratios in a significant manner.

- Eligible Liquidity Facilities

Further to our comments made in the cover letter, we would suggest that the BCBS continue to allow banks to apply a 50% CCF for eligible liquidity facilities. We note that eligible liquidity facilities:

1. are fully collateralized and are not call options on a banks' balance sheet;
2. clearly demonstrate very low contingent funding exposure;
3. are already reflected at 50% in the leverage ratios of certain jurisdictions (e.g. USA); and,
4. are in place to support senior securitizations, which result in unencumbered HQLA requirements to be reflected on balance sheet.

We discuss each of the above in further detail below:

1. The features of eligible liquidity facilities are self-limiting in that any borrowing or 'draw' under this category of facility (meeting existing Basel II criteria) requires a borrower to, among other things, deliver eligible collateral in order to receive funding. These facilities are not call options on banks' balance sheets, and as a result, do not create 'wrong way' risk that could allow borrowers to simply draw on banks in times of financial distress at either the borrower level or at a financial system level. To the contrary, these facilities serve to protect banks against correlated contingent funding exposure and thus create a lower contingent borrowing exposure due to the explicit requirement that there be sufficient eligible collateral available to secure the borrowing request.
2. We believe experience clearly demonstrates the very low contingent funding exposure associated with eligible liquidity facilities. Indeed, during times of financial stress, the financing needs of bank securitization customers has been shown to generally decline as their need for working capital or receivables financing decreases. The amount of receivables available to finance would also likely decline. As such, it is logical to expect that usage of bank customer securitization credit facilities, like the usage of traditional bank revolving credit facilities, would decline during times of economic duress. This is precisely what the data during both benign times and during periods of financial stress has shown. The various industry groups have submitted robust data to this effect during the LCR consultative process and we similarly note the very low and stable draw experience articulated in those comment letters and supporting presentations.

3. We believe by preserving the eligible liquidity facility framework, Canadian banks and other international banks would remain on equal footing with US banks which retain 20% and 50% CCFs for an even broader category of backstop liquidity facilities extended to securitization transactions when compared to eligible liquidity facilities. This point is particularly relevant given the significant overlap in business models and the competitive environment that Canadian banks operate under in terms of client base and the types of transactions.
4. The economic impact of requiring a 100% CCF for all backstop liquidity facilities will introduce significantly higher costs associated with providing these facilities in a counterintuitive fashion. To the extent that banks have to apply a 100% CCF to all securitization backstop liquidity facilities, the sum total of the exposure for the transaction (for Leverage Ratio purposes) will exceed the notional of the commitment that the bank has provided. For example, if a bank extends a \$100MM eligible backstop facility supporting a client's securitization transaction, the bank would have the \$100MM Leverage Ratio exposure plus the entire amount of 'High Quality Liquid Assets' (HQLA) that the bank is required to hold on its balance sheet to defease the associated calculated outflow (which for securitization facilities can end up being 100% of the facility as well). The result is that the amount of Leverage Ratio capital that banks will need to set aside against these eligible liquidity facilities will almost always significantly exceed the actual exposure that the BCBS is trying to capture, creating a meaningful economic cost for facilities that have structural protections to mitigate 'wrong way' exposure. In fact, it will always cost more for a bank to provide an eligible liquidity facility to a client than to provide a drawn loan. Clients will therefore have to pay for this facility even in circumstances where they cannot access the facility, creating a significant incremental cost to these facilities – facilities that are a cornerstone of bank clients as they manage their own business and asset/liability profiles. It is important to note that because most eligible liquidity facilities support senior securitization exposures, the combined effect of a 100% CCF plus the HQLA Leverage Ratio contribution translates into a securitization risk weight floor that significantly exceeds the current risk weights under the Basel II guidelines as well as the risk weights in the BCBS 'Revisions to the Securitization Framework' document. For example, with a 10% capital ratio, the implied risk weight from the Leverage Ratio (with a 3.5% minimum requirement) will be at least 35%, which is almost twice as high as the same risk weight for a 5-year AAA securitization exposure in the Revisions document.

We note that regulators in both Europe and the US have adopted a similar CCF framework for LCR purposes that allows for a less than 100% outflow assumption for certain types of transactions. We believe preserving a 50% CCF for eligible liquidity facilities would be consistent with these approaches and would recognize the modest exposure arising from these limited class of contingent transactions. As such, we suggest that the BCBS consider reflecting eligible liquidity facilities in the leverage ratio based on a 50% CCF.

III.4 Treatment of traditional securitisations

- The CBA supports the BCBS's efforts to clarify the treatment of traditional securitizations for the purposes of the leverage ratio and to ensure consistent application across banks and jurisdictions. We believe banks that have demonstrated significant risk transfer for securitized assets should exclude those assets from the regulatory scope of consolidation and the Basel III leverage ratio exposure measure.

III.5 Treatment of securities financing transactions

- Regarding paragraph 37 (page 11), we hope that once the impact is assessed, further clarification will be provided. We request that the BCBS provide more clarity with respect to capturing CCR for SFTs in the context of triparty repos to incorporate the agent.

(b) Derivative exposures

- In the second bullet of paragraph 26 of the consultative document (page 8), it is not clear whether the BCBS will continue to allow for a deduction of the CVM provided separate from the replacement cost (RC) calculation in paragraph 2 of the Annex (page 21). We understand that CVM provided must be added back for the RC calculation as it would create exposure for the bank providing the CVM to the extent that it exceeds the net negative RC. However, the original intent of having the deduction for CVM provided was to recognize the CVM provided as a form of pre-settlement payment and as such, for it to offset the associated cash collateral receivable on balance sheet (or the gross-up required per paragraph 24 in the consultative document for banks that do not recognize this receivable on balance sheet). The latest BCBS proposal has kept this intent (as per paragraph 25), and therefore we would appreciate if the BCBS could clarify its language for the second bullet point in paragraph 26 to explicitly provide for a continued deduction of CVM.
- We suggest the following wording change to help clarify the BCBS's intent:

“In the case of cash variation margin provided to a counterparty, the posting bank may deduct the resulting receivable from its leverage ratio exposure measure, where the cash variation margin has been recognised as an asset under the bank’s operative accounting framework. In addition, to recognize the increased counterparty credit risk resulting from the cash variation margin provided, include this amount in the calculation of the derivative replacement cost as specified in paragraph 2 of the Annex.”