ASSOCIATION DES BANQUIERS CANADIENS | CANADIAN BANKERS ASSOCIATION

Darren Hannah
Vice-President
Finance, Risk & Prudential Policy

Tel (416) 362-6093 ext 236
Fax (416) 362-8465
dhannah@cba.ca

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

March 12, 2019

Dear Basel Committee members:

Re: CBA[1] Comments on BCBS Consultative Document *Revisions to leverage ratio disclosure requirements*

Thank you for the opportunity to provide comments on the BCBS's consultative document *Revisions to leverage ratio disclosure requirements*. We understand that the proposed revisions to the leverage ratio disclosure have been suggested because of the Committee's concern about banks' "window-dressing" behaviour in the form of temporary reductions of transaction volumes in key financial markets around public reporting dates. However, we do not believe that the proposed revisions to the leverage ratio disclosure will prevent "window-dressing" behaviour from occurring in jurisdictions where this type of activity may be of concern. Moreover, we do not believe "window-dressing" behaviour is a significant concern in Canada.

We note that movements in the leverage ratio exposure measure around quarter-end can be due to the volatile nature of repo funding. Repos are carried out to facilitate clients' and own funding activities. We also note that derivative activities are primarily client driven and conducted on commercial terms - fair values of derivative contracts are priced on observable market rates, and the positions are largely hedged. As such, we believe there is a lower risk of "window-dressing" behaviour for derivative exposures since these activities are based on earlier agreed contract terms and related hedging.

We also suggest the Committee consider that some banks may not have large investment banking businesses and would therefore not experience significant enough volatility in these exposures intra-month to materially impact the leverage ratio. Not only is the impact on the leverage ratio potentially immaterial, but the cost of implementing and supporting the required additional leverage reporting would be significant. We believe the BCBS should strongly consider this cost/benefit disparity. We also highlight that Canadian banks already generally disclose their leverage ratios to one decimal place and significant movements in leverage exposures would be reflected. Increased transparency for market participants is also provided by the fact that Canadian banks disclose average asset balances in their supplementary financial information.

Overall, we are concerned that the proposed revisions to the leverage ratio disclosure requirements will:

- Impose significant operational burden on banks to produce regulatory daily averages for Securities Financing Transactions (SFTs) and derivatives without clear evidence that "window-dressing" behaviour is of material concern in major jurisdictions.
- Confuse market participants as there would be two leverage ratios presented in one disclosure template.

[1] The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca.

- Increase execution risk for banks as the timing of implementation would be concurrent with several other highly complex regulatory rules and initiatives, including the Fundamental Review of the Trading Book (FRTB), Basel III reforms, and interest rate benchmark reform.

For the reasons above, we suggest that the Committee allow for a longer observation period following the recent October 2018 publication of the "Statement on leverage ratio window-dressing behaviour" in order to assess whether any changes have been made in jurisdictions where this type of activity is a concern. Should concerns still remain, we recommend that national discretion be introduced into the BCBS's leverage ratio disclosure to allow national supervisors to decide whether to apply additional leverage ratio disclosure requirements in their jurisdictions. For jurisdictions that decide to proceed, we suggest that disclosing daily average balance sheet figures (rather than figures derived from regulatory calculations) for SFT and derivative leverage exposures would be a more practical and operationally feasible approach for the BCBS to consider. We also suggest that a reasonable implementation timeline be considered for any new disclosure given the other significant complex regulatory projects currently underway.

Significant systems development will be required for banks' financial reporting

The proposed revisions entail significant systems development work in banks' capital reporting engines to produce the required additional disclosure information. Canadian banks' systems and infrastructures are not setup to generate daily regulatory calculations of leverage exposures as banks currently produce only quarterly leverage ratio calculations for their quarterly financial statements.

Specifically, the determination of leverage exposure amounts for SFTs and the Replacement Cost (RC) of derivatives, as calculated under the leverage ratio framework, is a very intense operational process exercise. Calculating the leverage exposure requires a significant amount of back-end data processing using the information provided by front/middle-office systems, and banks are not equipped to have this calculation done on a daily basis.

As an example, many banks perform the calculation of derivative leverage exposure values after taking into consideration OTC derivatives netting and variation margin received. In fact, for many banks the exposure amount calculation is performed using a capital engine from a third-party vendor, requires trade feeds and associated collateral/CSA feeds, and results in a complicated and very time-consuming process.

Significant investment in systems development and data sourcing would be required to fully automate and shorten the timeframe before the daily average value could be calculated. This is further complicated by the complexity of the SA-CCR methodology which is now fully adopted in Canada. The calculation of derivative exposure amounts on a daily basis using the SA-CCR methodology would require significant additional investment in our reporting infrastructure without providing sufficient operational benefit for the cost incurred. This is because this reporting is done by netting set and based on CSA agreements and differs from the reporting of daily balance sheet values. We question the need to run banks' capital engines on a daily basis when the leverage ratio is considered a backstop measure.

In relation to the mean value of SFT assets after netting, banks may also conclude that their repo settlement satisfies the "functional equivalent of net settlement" under paragraph 51(i) of the Leverage Ratio standard in *Basel III: Finalising post-crisis reforms*. As a result, repo receivables and payables are netted on month-end closing while the intra-month daily balances are gross as booked and fed from front office systems. We believe that performing daily SFT netting in order to calculate the daily average value for leverage ratio disclosure purposes would be very onerous.

In addition, significant system changes and additional resources would also be required to perform daily reconciliation to the balance sheet, validations, and overrides to ensure that the revised leverage ratio disclosures have the same level of accuracy as our quarter-end data. Manual adjustments for accounting quarter-end/monthly purposes would also be difficult to replicate daily.

Further clarification would also be required by the BCBS in relation to how rows 7, 13, and 18 of the leverage ratio common disclosure template should be amended to include the mean values for calculating the total mean leverage exposure.

Revised leverage ratio disclosure requirements could cause market confusion

The BCBS's leverage ratio disclosure framework was endorsed by jurisdictions for implementation based on the *Basel III leverage ratio framework and disclosure requirements* (January 2014) and the revised leverage ratio framework under *Basel III: Finalising post-crisis reforms* (December 2017). Under these frameworks, the leverage ratio is meant to reflect the Tier 1 capital measure and leverage ratio exposure measure at quarter-end[2]. We believe that also disclosing a Basel III leverage ratio that requires daily mean values will create confusion for market participants that use the leverage ratio for decision-making purposes such as evaluating the financial stability or financial strength of a bank. We are concerned that market participants will face uncertainty as to the relevant leverage ratio to use – the daily mean or the quarter-end leverage disclosure. Based on the revised leverage ratio common disclosure template, would market participants rely on Row 25: "Basel III leverage ratio (including the impact of any applicable temporary exemption of central bank reserves)" or Row 32: "Basel III leverage ratio (including the impact of any applicable temporary exemption of central bank reserves (incorporating mean values from row 28, 29, 30)"?

Increased execution risk from concurrent implementation with other large regulatory projects

Global banks are in the midst of implementing multiple, highly complex infrastructure projects to meet the increasing demands of new international regulatory requirements. These include FRTB, Basel III reforms, and interest rate benchmark reform. Some of these requirements were only recently finalized such as FRTB and/or involve a significant number of changes such as the Basel III reforms. Adding the revised leverage ratio disclosure requirements to this menu of work would place heightened pressure on already strained resources and execution capacity. Should the BCBS conclude that there truly is a global concern around "window-dressing" and the benefits of the revised leverage ratio disclosure requirements to financial stability outweigh the associated costs, we would recommend that a phased-in approach be adopted so that resources are not withdrawn from other BCBS regulatory implementation projects currently underway.

Disclosure of mean value for central bank reserves

In addition to our concerns noted above, we seek clarification as to why the Committee would require all jurisdictions to separately disclose the mean value of central bank reserves that are not subject to any applicable temporary exemption from the leverage exposure measure. We note that such disclosure is only required under the finalized Basel III reforms when a temporary exemption is granted under exceptional macroeconomic circumstances[3]. If a temporary exemption is not in force, we suggest there should not be separate disclosure requirement of central bank reserves[4] as they would already be included in another row within the leverage ratio common disclosure template. We believe this additional disclosure is unnecessary

[2] *Basel III leverage ratio framework and disclosure requirements* (January 2014) 46. "at a minimum, three items must be publicly disclosed quarterly irrespective of the frequency of publication of the financial statements: (i) the numerator (Tier 1 capital); (ii) the denominator (exposure measure); and (iii) the Basel III leverage ratio according to paragraph 6. At a minimum, these disclosures should be on a quarter-end basis, along with the figures of the prior three quarter-ends. However, banks may, subject to supervisory approval, use more frequent calculations (eg daily or monthly averaging), as long as they do so consistently".
Basel III: Finalising post-crisis reforms (December 2017) Leverage ratio 6. "Both the capital measure and the exposure measure are to be calculated on a quarter-end basis. However, banks may, subject to supervisory approval, use more frequent calculations (eg daily or monthly averaging) as long as they do so consistently".
[3]*Basel III: Finalizing post-crisis reforms* (December 2017). "26. At national discretion, and to facilitate the implementation of monetary policies, **a jurisdiction may temporarily exempt central bank reserves from the leverage ratio exposure measure in exceptional macroeconomic circumstances**. To maintain the same level of resilience provided by the leverage ratio, a jurisdiction applying this discretion must also increase the calibration of the minimum leverage ratio requirement commensurately to offset the impact of exempting central bank reserves. In addition, in order to maintain the comparability and transparency of the Basel III leverage ratio framework, **banks will be required to disclose the impact of any temporary exemption alongside ongoing public disclosure of the leverage ratio without application of such exemption**." **(emphasis added).**
[4]Despite our views above and in response to a question posed in the consultative document, we note that central bank reserves support the banks' liquidity requirements and therefore daily reporting of these values would not be expected to impact the willingness to utilize these facilities or

for most jurisdictions and therefore does not require a modification to the current leverage ratio disclosure template.

Recommended Path Forward

As noted earlier, we recommend that the BCBS allow for a longer period of observation to assess any changes made within jurisdictions following the issuance of the "Statement on leverage ratio window-dressing behaviour" (October 2018). Should the BCBS still have concerns over window-dressing behaviour, we recommend that national discretion be introduced into the BCBS's leverage ratio framework to allow national supervisors to decide whether to apply additional leverage ratio disclosure requirements in their jurisdiction. For jurisdictions that decide to implement additional disclosure, we suggest that disclosing a daily average balance sheet view (rather than regulatory components of the SFT and derivative leverage exposure measure) would be a more practical and operationally feasible approach. We also suggest that a reasonable phase-in period be permitted for any new disclosure given the other significant regulatory projects underway.

Thank you in advance for considering our comments. We would be pleased to discuss our submission at your convenience.

Sincerely,

Cc: Brian Rumas, Managing Director, Bank Capital, Capital Division, OSFI
Catherine Girouard, Director, Bank Capital, Capital Division, OSFI
Patrick Tobin, Capital Specialist, Capital Division, OSFI
Mark Joshua, Senior Analyst, Capital Division, OSFI
Ken Leung, Director, Accounting Policy Division, OSFI
John Gotzamanis, Senior Accounting Advisor, Accounting Policy Division, OSFI

reveal inappropriate use. Furthermore, exposure buffers are typically held to manage any volatility swings in central bank reserves which could be driven by liquidity needs.