

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

Submitted via website upload

Zurich, 6 July 2016

Credit Suisse response to the Consultative Document on 'Revisions to the Basel III leverage ratio framework' (BCBS 365)

Credit Suisse Group AG ("CS") would like to thank the Basel Committee on Banking Supervision (the Committee) for the opportunity to comment on the consultation document 'Revisions to the Basel III leverage ratio framework' (BCBS 365). We are fully supportive of the Committee's objectives for revising the leverage ratio framework, but would urge the Committee to give full consideration to the responses from CS and other industry participants.

CS played an active role in, and fully supports, the response and key findings to the consultative document provided to the Committee by the Global Financial Markets Association, the Institute of International Finance, and the International Swaps and Derivatives Association, together the "Joint Association". Outlined below are the themes in the Joint Association's response that CS believes are the most important for the Committee to consider. In addition, we provide more detailed responses to the individual issues we deem significant in the consultative document in the Appendix to this letter.

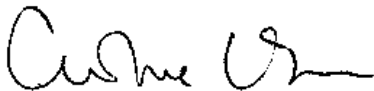
- **Adoption of a Modified Version of the Standardised Approach for Measuring Counterparty Credit Risk (SA-CCR) and Treatment of Derivatives Cleared through Central Counterparties** – The incorporation of the SA-CCR in the leverage framework introduces a risk-based element by applying a 1.4 alpha factor to the replacement cost of derivatives. We therefore find it difficult to justify the multiplier in the leverage exposure, despite the design of the ratio to be a non-risk-based framework. Additionally, we feel the leverage framework should more favorably promote the clearing of derivatives through central counterparties.
- **Treatment of Regular-way Purchases and Sales of Financial Assets** – Of the two options proposed by the consultative document, CS agrees that Option B is the preferable methodology in that it fulfills the objective of aligning the current difference across accounting frameworks, but also reflects a benefit to market makers who may have unfavorable and volatile consequences of trade date accounting on the size of their balance sheet and hence to total leverage exposure.
- **Revisions to the Credit Conversion Factors for Off-Balance Sheet Items** – CS previously commented on the Second Consultative Paper on Revisions to the Standardised Approach for Credit Risk (BCBS 347) in March 2016. That proposal would result in material increases in credit conversion factors for off-balance sheet exposures, particularly for unconditionally cancellable lending commitments, which allow a bank to unconditionally deny a draw under the lending agreement. Although we agree that credit conversion factors should be consistently applied for both capital requirements under the

credit risk framework and the leverage ratio framework, we feel that the increased cost for our clients to secure financing will limit the flexibility to manage their business.

- **Treatment of Traditional Securitizations** – CS agrees that there should be consistency in the treatment of traditional securitizations between the risk-based capital framework and the leverage ratio framework, whereby the leverage exposure should take into account the significant risk transfer aspects of the risk-based framework and not rely solely on accounting consolidation.
- **Treatment of Securities Financing Transactions** – CS believes that open-maturity reverse repurchase agreements and repurchase agreements function in the same manner as overnight transactions with an explicit maturity date of one day. The optionality embedded within open-maturity transactions is used to alleviate the operational burden of extending overnight transactions if needed by the counterparty. Therefore, we believe that the requirement that they have the “same explicit final settlement date” should be deemed to be met for netting purposes for all repos with an open or explicit overnight maturity of one day.

The changes proposed in BCBS 365 are not happening in isolation, but in parallel with a major overhaul of the regulatory capital framework. We therefore encourage the Committee to adopt final rules only once a holistic QIS has been completed and following an assessment of cumulative impacts taking into account the forthcoming rules on capital floors. This will allow the Committee to fully understand the overall impact of the proposals and help to ensure the final rules fulfill the Committee’s intended result, and do not lead to aggregate capital increases across the banking sector.

Yours sincerely,



Charlotte Jones
Managing Director
Head of Group Finance



Christine Gatti
Managing Director
Group Accountant

APPENDIX - Detailed CS comments

Adoption of a Modified Version of the Standardised Approach for Measuring Counterparty Credit Risk (SA-CCR) and Treatment of Derivatives Cleared through Central Counterparties

SA-CCR

The adaptation of the SA-CCR includes the risk-based alpha multiplier without a basis for its application in the leverage framework. The alpha multiplier was introduced to enhance the translation of expected potential exposure to a loan-equivalent exposure at default (EAD) for the purpose of calculating derivative counterparty credit risk. When measuring risk, we believe the alpha multiplier is a well-regarded method to account for several regulatory concerns, including diversity in banks' internal portfolio risk models, future exposure variance, potential overstatement of diversification benefits, and correlation of a derivative's underlying reference variable with counterparty credit risk. However, under the leverage framework, the absolute value for independent exposures to each counterparty and transactions are summed, without bank diversification or other risk mitigation regarded. In the context of measuring the leverage denominator associated with derivative exposures, the application of the alpha factor multiplier is inconsistent with the purpose of the leverage framework where it adjusts for a portfolio risk effect, which is not present.

Client Clearing Services

We agree with the concerns expressed broadly by market participants, financial market infrastructures, market regulators and clearing members regarding the current application of the leverage framework to a bank acting as Client Clearing Broker (Broker). Since the Broker has only a contingent credit exposure profile, the segregated client margin posted to a central counterparty (CCP) for the sole purpose of covering the potential future exposure (PFE) of the client's trades should be wholly or partially recognized to reduce PFE. By law and regulation, segregated client margin is separate from the Broker's funds and positions, takes the form of cash and cash-like instruments, and is actively calibrated by the client's CCP, which itself is a regulated financial market infrastructure. For these reasons, we are concerned that the leverage framework does not accurately measure the PFE faced by a Broker.

Without proper sizing of the Broker's PFE measurement, and without recognition of the exposure reducing effect of segregated client margin, a Broker and its clients have very limited, if any, means to manage the leverage framework's impact on clients' accounts. There is currently little sign of growing clearing brokerage services provided by non-bank entities. To the extent additional bank clearing brokers withdraw or limit their services to market participants of all types due to the challenges in the leverage framework, we feel that market liquidity and CCP resiliency is likely to suffer, the migration to centralized clearing by the real economy will be undermined, and clients may experience barriers to portability in all market conditions. We strongly encourage the BCBS to generally recalibrate the PFE specific to a bank clearing broker or to regard the segregated client margin posted to a CCP to calculate the Broker's PFE.

Market Making in Cleared Derivatives

A healthy clearing system supports a diverse group of qualified CCPs (QCCPs) and clearing member market makers so they can offer robust liquidity in equivalent cleared derivative instruments. Conversely, we observe that increasing concentration at a small number of QCCPs threatens safe and efficient financial markets and contributes to price discrepancies or basis among QCCPs across equivalent-cleared instruments. The current leverage framework creates challenges for clearing member banks seeking to provide bona fide liquidity in substantially equivalent-cleared instruments at efficient prices. We suggest that the BCBS consider carefully how the leverage framework can foster, and certainly not undermine, the use of multiple QCCPs by market participants.

Treatment of Regular-way Purchases and Sales of Financial Assets

We agree with the committee that there should be parity in the calculation of leverage ratio across different accounting frameworks. The consolidated financial statements of CS are prepared in accordance with accounting principles generally accepted in the US (US GAAP), whereby regular-way security transactions are required to be recorded on a trade-date basis. Additionally under US GAAP, broker-dealer entities may report on a net basis payables and receivables from unsettled, regular-way transactions associated with clearing through an entity that provides for and guarantees net settlement. In certain jurisdictions where International Financial Reporting Standards (IFRS) are required for stand-alone reporting of certain entities, regular-way security transactions are recorded on a settlement-date basis, and payables and receivables from unsettled, regular-way transactions are not permitted to be offset. Additionally, under settlement-date accounting, the current leverage ratio framework requires an off-balance sheet commitment at a 100% credit conversion factor (CCF) to be included in the leverage exposure for security purchases that have not yet settled, which achieves parity between trade-date and settlement-date inventory balances. However, there still exists divergence in total assets and hence total leverage exposure due to the offset of payables and receivables from unsettled, regular-way transactions under US GAAP, but not under IFRS.

The Committee has proposed two options to bring parity to the difference identified between the accounting frameworks. Option A removes the offset of payables and receivables from unsettled, regular-way transactions currently allowed under US GAAP for broker-dealer entities, whereby Option B allows the offset under both accounting frameworks, if certain conditions are met. Option A would artificially inflate the leverage ratio for transactions that are scheduled to settle in a short timeframe. Most transactions are cleared on a delivery-versus-payment (DvP) basis through clearing organizations that provide efficient and orderly trade clearance and settlement services. Transactions are netted at each clearing organization to one cash settlement position, i.e., if the contract amount of the securities to be received (purchased) is greater than that to be delivered (sold), CS has a payable to the clearing organization for the net cash movement. The DvP process ensures that either the cash or the security is held by the CS at the end of the day, but not both. Therefore, there is no reason to artificially inflate the leverage exposure for cash receivables attributed to unsettled financial asset sales as banks cannot and do not pledge or otherwise rehypothecate trade date receivables to meet other obligations. Additionally, the volume of purchase and sale market-making activity will create increased volatility in the leverage exposure, which may constrain the ability to execute client orders and reduce market liquidity. Based on proprietary preliminary estimates of the impact of Option A, leverage exposure would increase by 20%. We believe that Option B is the more appropriate measure of leverage relating to unsettled, regular-way purchases and sales and to achieve parity between the accounting frameworks.

Revisions to the Credit Conversion Factors (CCF) for Off-Balance Sheet Items

Significant increases in CCFs for off-balance sheet commitments under the current proposal of Standardised Approach for Credit Risk are extraordinarily punitive. Specifically, the CCF for unconditionally cancellable commitments for retail counterparties would increase from 0% to 10%/20%, and all other unconditionally cancellable commitments would increase to a uniform yet undecided 50%/75%. Additionally, the CCF for all irrevocable commitments, regardless of maturity would also increase from 20% or 50% (depending on original maturity) to 50%/75%. Our internal estimates for CCFs on unused limits for Swiss corporates are substantially lower than 50%, even including a margin of conservatism. Based on our understanding of the Global Credit Data, the proposed level of CCFs is far too high. Based on proprietary preliminary estimates of the range of proposed increases in CCFs, leverage exposure would increase between 4.5% and 10%.

There is a clear distinction in practice and legal contract wording between revocable and irrevocable loan commitments. From an economic and client point of view, a borrower would not pay a fee for a borrowing facility if the contract specifies that it is immediately cancellable. Not all such revocable facilities could be

migrated to committed lines that usually pay a fee, thereby increasing the cost of these facilities to clients and limiting the flexibility to manage their business. In many countries, not only Switzerland, the large banks are the main providers of these often unsecured, revocable facilities. Smaller banks cannot be expected to compensate with a sufficient volume under the same prohibitive CCFs. The related decline in available lending capacity will restrict companies in their flexibility and create substantial inefficiencies in lending. Given the material increase in CCFs, revocable facilities will no longer be provided or if so, only at a prohibitive cost. We are concerned that the contemplated introduction of unduly high CCFs on both revocable and irrevocable commitments will lead to curbed lending.

In summary, we see a clear need for a differentiation in CCFs between revocable and irrevocable facilities. We therefore propose that the 10% CCF be retained for undrawn unconditionally cancellable commitments and should not be limited only to retail counterparties, as well as retaining the 20% CCF for trade letters of credit, which is vital for global trade. Additionally, for irrevocable commitments, the CCF should be calibrated to the lower end of the 50%/75% range which is consistent with our internal and current industry data.

Treatment of Traditional Securitizations

Although there are no specific changes proposed for the scope in applicability of securitization vehicles in the leverage framework, the consultative paper discusses that the BCBS is working on further clarification regarding the treatment of traditional securitizations to potentially alleviate the inconsistency between the risk-based framework and the leverage framework. Certain securitizations achieve relief under the risk-based framework, but do not meet the requirements for accounting derecognition from the balance sheet and therefore are included in the leverage framework. The goal is to achieve consistency in the scope of consolidation between both frameworks by either including or excluding securitization vehicles. In our view, the consolidation of traditional securitizations should be harmonized between the risk-based framework and the leverage framework whereby deconsolidation should be based on the criteria of significant risk transfer as outlined in the risk-based framework irrespective of the applied accounting standard.

Treatment of Securities Financing Transactions

We believe that open-maturity reverse repurchase agreements and repurchase agreements function in the same manner as overnight transactions with an explicit maturity date of one day. The optionality embedded within open-maturity transactions is used to reduce the operational burden of extending overnight transactions if needed by the counterparty. To meet the requirements of netting under the current leverage exposure rules, netting of repos with optionality would need to be booked and rebooked daily in order to reflect a stated maturity date. This additional burden of manual booking and daily trade tickets creates significant operational risk. For example, if a bank has an open-maturity repurchase agreement and an open-maturity reverse repurchase agreement with the same counterparty, and the counterparty “closed out” one transaction, the bank could in turn close out the corresponding transaction. In this case collateral would be returned on both transactions and interest would be paid on a net basis. Operationally, the close-out procedures are exactly the same as if both repos were booked with matched-term final maturities. Additionally, as the market is moving towards cleared repos for both the “sell side” and “buy side”, open-ended repos will increase in volume. The ability to run a matched book via a clearinghouse on an open-ended basis will provide significantly more liquidity to the repo markets. With the current construct of open-maturity optionality, the repos function as overnight transactions with a maturity of one day. Therefore, we believe that the requirement that they have the “same explicit final settlement date” should be deemed to be met for netting purposes for all repurchase transactions with an open or explicit overnight maturity of one day. We cannot foresee a scenario that creates an unwanted outcome by including the netting benefits within the calculation of the leverage ratio; i.e., if an open-maturity reverse repurchase agreement is terminated, a bank can always terminate an open-maturity repurchase agreement to keep funding requirements constant.