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EBF response to the BCBS consultation on revisions to leverage ratio disclosure requirements

Key points:

- The EBF strongly believes that the problem of "window-dressing" should be primarily addressed as part of the supervisory process on an entity specific basis
- The EBF is concerned about the suggestion to use daily values for the calculation of the leverage ratio due to the high regulatory costs. Furthermore, a more frequent calculation than the current one endangers the comparability of the leverage ratio with the capital metrics
- Nevertheless, if some items were to be calculated on an average basis of the quarter, this should only be the case for asset exposures that could generate "window-dressing", while at the same time respecting the proportionality rules of each jurisdiction
- The EBF holds the view that only repos/ reverse transactions are amenable to window-dressing. Replacement cost (RC) of derivative exposures and central bank reserves that are included in on-balance sheet exposures should be excluded from the revision of the disclosure requirements

The EBF would like to thank the Basel Committee on Banking Supervision (BCBS) for the opportunity to comment on the consultative document "Revisions to leverage ratio disclosure requirements". The EBF and its members appreciate the opportunity to express their views on this new regulatory initiative.

Furthermore, the EBF is very much committed to address the problem of "window-dressing" and welcomes the proposal of the BCBS. The EBF strongly believes that the problem of "window-dressing" should be primarily addressed as part of the supervisory process on an entity specific basis.

In addition, the EBF is concerned about the increasing amount of information that needs to be disclosed by banks. That is why EBF carefully assesses the short list of assets proposed by the BCBS that would deserve a more frequent calculation for leverage ratio disclosure, in relation with the "window-dressing" monitoring objective.

The BCBS proposes to require banks to calculate leverage ratios for the following exposures as an average of daily values for the entire quarter:

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- Adjusted gross securities financing (SFT) assets recognised for accounting purposes (as calculated per paragraph 51 (i) of the leverage ratio standard);
- Replacement cost (RC) of derivative exposures; and
- Central bank reserves that are included in on-balance sheet exposures.

The EBF is concerned about the suggestion of the Committee to use daily values as a basis for the calculation of the leverage ratio for the following reasons:

Firstly, the calculation of leverage ratios based on daily values is extremely burdensome on banks and would impose significant one-off and ongoing costs on those banks, which consist of adjusting entire internal processes and IT systems to this new requirement. For example, daily values are not audited and usually not subject to the same internal controls as quarter end values. Establishing the same level of controls as for accounting reports is necessary to comply with the BCBS Revised Pillar 3 disclosure requirements guidance.

Secondly, EU banks are well aware that they must be compliant **"at any time"** with the regulatory ratios.

Thirdly, a more frequent calculation than the current one would endanger the comparability of the leverage ratio with the capital metrics (which in the EU are calculated on quarterly basis) and potentially create confusion concerning the interpretation of the capital adequacy of an institution.

To address the issue of window-dressing, **the EBF suggests that supervisors should monitor more closely banks that are suspected to violate the leverage ratio and supervisors should request more frequent reporting from those banks**.

Nevertheless, **if some items were to be calculated on an average basis of the quarter, and publicly released as quarterly averages, this should only be required:**

- **For the asset exposures that could generate "window-dressing"**
- **Meeting the proportionality rules entered into force in the jurisdiction**

1- Perimeter

Only the securities financing (SFT) assets have been identified as the asset class that could generate "window-dressing"

From the short list proposed by the BCBS, only the repos/reverse repos transactions (SFTS) are amenable exposures to rapid reduction via short- term trades at quarter end.

In addition, in recent months, several studies raised concern about "window-dressing practices" by EU banks, as a reason behind liquidity drying up at end of quarters. Such comments pointed out the repo market only and were based on the Box III,A 'Banks' "window-dressing": the case of repo markets' published in the BIS Annual Economic Report 2018 (Graph IIIA Banks' window-dressing through the lens of US repo markets'). Nevertheless, it is necessary to gain further understanding of the observations and data that have led to the Committee's decision to propose enhanced leverage ratio disclosure. Indeed, the concern about potential "window-dressing" has gained momentum based on an observation focused on repos with US Money Market Fund. There was no attempt to analyse the dynamics of this specific market, before jumping to the conclusion that the quarter end moves were actually due to "window-dressing" by some market participants.

In addition, there was no analysis of the broader repo market including €, yen and other major currencies.

The other Exposure classes should be excluded for the calculation of the leverage ratio, on an infra-quarterly basis

Replacement cost (RC) of derivative exposures

As a rule, derivative contracts are based on contractual agreements governing netting and the cash variation margin. These agreements are mainly concluded for a long period of time. The bank therefore has little opportunity to carry out window-dressing to the extent that the effects on the leverage ratio are noticeable. In addition, the measures are limited by the current valuation of the contracts. The increase in the leverage ratio due to the termination of a derivative contract is contrary to the realisation of a negative market value due to the termination.

In particular, in the case of sovereign and corporate non-collateralized counterparties, movements (usually non-significant) in the measure are **market driven** and do not relate to changes in the volumes of bank transactions, and therefore do not contribute to any potential window-dressing. Similarly, in the case of collateralized counterparties, a difference in timing between the PV and the collateral received/posted (usually a few days) could generate some replacement cost evolutions even if the bank has not changed its positions. Once again, this RC volatility is not related at all to window-dressing. With this in mind, the EBF does not understand how the disclosure of average values at replacement costs can lead to a reduction in window-dressing.

Central bank reserves that are included in on-balance sheet exposures

Furthermore, the EBF questions the view expressed in the consultation paper that any window-dressing and regulatory arbitrage could be related to central bank reserves. The variability of CB reserves is not due to proactive management decisions. Rather, the amount of CB reserves is the **net result of daily business flows** that, by construction, can be very volatile. The disclosure of daily average CB deposit would not provide significant added value to investors.

In addition, EBF is concerned that the **disclosure** of central bank reserves could be quite **sensitive** and that it could cause unnecessary procyclical market reactions in certain market circumstances. It is highly important that disclosure requirements do not discourage banks from accessing central bank facilities and that as such we suggest that the associated disclosure requirements should be deleted.

The **only case where disclosure of CB deposits** may be relevant would be in case the **exemption from leverage exposure** may be activated, under exceptional monetary policy circumstances.

2- Proportionality rules should be respected

Due to the high costs that would result from the implementation of the proposal published by the BCBS, the EBF suggests that the BCBS allows each jurisdiction to implement the final standard according to the proportionality granted in its prudential rules, which, for the EU is laid out in the Capital Requirements Regulation II (CRRII).

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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