POSITION PAPER

# ESBG response to the BCBS consultation on disclosure requirement to address leverage ratio window-dressing

ESBG (European Savings and Retail Banking Group)

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ESBG

Dear Sir/Madam,

Thank you for the opportunity to provide our feedback to the BCBS consultation on disclosure requirement to address leverage ratio window-dressing. We would like to share with you the following reflections that we hope will be taken into account by the BCBS.

**General Comments:**

ESBG appreciates the efforts undertaken by the BCBS to frame Basel III including a simple, transparent and non-risk-based measure, the leverage ratio, to act as a credible supplementary tool to the risk-based capital requirements. The leverage ratio is the intended restriction for the build-up of (excessive) leverage in the banking sector and therefore to avoid a destabilising deleveraging process that could damage the broader financial system and by that the real economy; and in this, it reinforces the risk-based requirements with a simple, non-risk-based "backstop" measure.

Since establishing the leverage ratio, some of our members have experienced (as with any other risk-based or non-risk-based measure as well) a certain range of volatility. Nevertheless, while risk-based measures give a guideline to become active with risk-reduction tools in the short term to handle certain complex operations in everyday banking business without overarching a set risk framework that can become critical with the next market event. On the other hand, the non-risk-based measure leverage ratio shall give a guidance for the long term developments. Both approaches are the two sides of the same coin that complement each other.

The Consultation Paper refers to a heightened volatility of money and derivatives markets around key reference dates (e.g. quarter-end dates). This has alerted the Committee to potential regulatory arbitrage by banks with particular concern of "window-dressing". This reference is the only justification for extending disclosure requirements. The BCBS has provided neither empirical evidence nor other facts and figures to justify the hypothesis. Without a sufficient description of the basis for the decision, we reject the blanket extension of the disclosure requirements. The efficiency and effectiveness of the chosen measure cannot be assessed without a plausible basis.

Against this background, we do not see the necessity for a leverage ratio that becomes calculated on average data that forces the institutions to deal with evaluations on a daily basis. Though the draft approach foresees the average information for a limited number of parameters only, but there are two aspects to be considered. First, even in case of a single parameter that needs to be evaluated and incorporated into an average calculation the whole calculation process needs to be done with the same rate as the single parameter. Otherwise, the demand for disclosure of changes in the leverage ratio based on selected parameters could not be fulfilled. Second, based on the experiences over the last decade, we also see the tendency of legislators and supervisors to amplify their requirements instead of cutting back.

ESBG also questions the additional value of these addionally disclosed information as it does not tell anything about the real circumstances driving the measured volatility. Taking the experiences of some of our members, these parameters are more likely to be driven by customers or contract partners than by the intension of 'window dressing'. Furthermore, current disclosure requirements are not only highly burdensome to institutions, but also create something like an informative overload for the interested reader.

Beside the above described misleading conceptual approach of average calculations with the leverage ratio as described above, we want to highlight the burdens that would be added to the already existing as well as regulatory requirements which are still 'under construction' and that have to be implemented throughout the next years.

In light of this, in ESBG's view, the BCBS should incorporate a few facts when developing its regulatory requirements to institutions:

- The fact of a diverse banking industry and the impracticality to regulate by a one-size-fits-all approach;
- The fact that any additional burdensome regulation will diminish the ability of institutions to follow its mission to serve as a stable capital provider of economies and thus reinforces tendencies to seek financial products at unregulated markets.

**To summarise, ESBG believes that the transparency of the leverage ratio calculation by the intended approach is highly questionable and surely cannot be guaranteed, and the simplicity of the non-risk-based leverage ratio tends to disappear, which leads to disregard the fundamental principles of establishment the leverage ratio at the first place.**

**We see the proposed calculation of the leverage ratio on an average of daily values extremely burdensome, cost intensive and not proportionate to the regulatory objective pursued.**

As an alternative to the proposed approach, we would suggest to keep the current calculation on a quarterly-end basis instead to propose a new exposure calculation based on an average of daily values. Accordingly, the standard compromises - a 3% minimum level that banks must meet all the times - would remain.

However, being aware of the concern that this issue rises in the supervisory community, any additional requirement related to the leverage ratio should take into account a proportionality criterion. In this sense, we believe that the most convenient option would be to enhance the control and response of the supervisor to entities that specifically perform window dressing practices. The regular reporting that should be performed with daily data, if necessary, should be limited to entities to which it is expressly requested by its Competent Authority based on possible significant window dressing evidence.

If, on the contrary, this information ends up being an obligation of Pillar 3 for all entities, at least, the Competent Authority should be allowed to alleviate this type of reporting to entities where there is not a supervisory benefit that compensates the cost of having to perform this breakdown.

From the short list proposed by the BCBS, only the repos/reverse repos transactions (SFTS) are exposures that may be subject, allegedly, to rapid reduction via short- term trades at quarter end. In recent months, several studies have pointed out some presumed "window-dressing practices" by banks, as a source of liquidity drying up at the 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'). Besides, it should be noted that new process of information disclosure could diminish the highly liquid feature of the repo markets and, consequently, a slowdown of one of the transmission channels of monetary policy. In addition it should be recognized that repos are also a common and important tool to the institutions that guarantees a rapidly accessible liquidity in cases it's needed. Any limiting condition caused by a further regulation, even for the right reasons, could also limit the institutions access to liquidity markets and might accidentally cause other negative consequences.

Moreover, the other exposure classes that should be excluded for the calculation of the leverage ratio on a daily basis are:

- Replacement cost (RC) of derivative exposures:
  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. Moreover, the volatility of the replacement cost of derivatives exposures is mainly driven by market parameters volatility and not by bank or client decision. Accordingly, we do not see 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:
  We do not share the BCBS' views that any window dressing and regulatory arbitrage could be related to central bank reserves.

The public disclosures of an average of daily calculations should only be done with management data on a best effort basis, as evidenced by UK and US banks experience and allowed by UK and US regulators. Daily Values to be used for the calculation of leverage ratios should not be based on accounting values, but they should be based on a management data and a best effort basis.

As there might be difficulties in valuing the assets, applying the leverage ratio netting rules and even eliminating intra group transactions (for the group consolidated ratio) at the end of each day, the best way would be to adopt a pragmatic approach. When banks close their books at quarter end, it requires many adjustments which are almost impossible to mimic on a daily basis. Hence, ESBG would propose to apply a 'materiality' concept, by passing the smaller adjustments and focusing only on the most material ones (possibly based on sensitivity of the leverage ratio).

Finally, given the high costs generated by the implementation of the proposed disclosure requirements, ESBG would suggest that the final standards of the BCBS should be implemented according to proportionality rules in each jurisdiction.

**About ESBG (European Savings and Retail Banking Group)**

ESBG represents the locally focused European banking sector, helping savings and retail banks in 20 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 1,000 banks, which together employ 780,000 people driven to innovate at 56,000 outlets. ESBG members have total assets of €6.2 trillion, provide €500 billion in SME loans, and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking.

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