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Banking Federation**

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
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July 6, 2016

Dear Sir/Madam:

Re: *Consultative Document-Revisions to the Basel III leverage ratio framework*

The IBFed¹ appreciates this opportunity to comment on the Basel Committee on Banking Supervision (BCBS) proposal to revise the Basel leverage ratio and share with you our views.

Overall, IBFed supports the Committee's efforts to introduce a leverage ratio as a supplemental, backstop measure to the risk-based measure. In its current form, however, certain aspects of the Proposed Framework could greatly increase the denominator of the Basel III leverage ratio ("the Exposure Measure") by adopting measurement methodologies that we believe could significantly overstate actual economic exposure. If the final standard overstates the Exposure Measure, it is far more likely to result in the leverage ratio, rather than the risk-based capital ratio, becoming the binding capital measure for a substantial number of banks.

¹ The International Banking Federation (IBFed) was formed in March 2004 to represent the combined views of a group of national banking associations. The countries represented by the Federation collectively represent more than 18,000 banks with 275,000 branches, including around 700 of the world's top 1000 banks which alone manage worldwide assets of over \$31 trillion. The Federation represents every major financial centre and its members' activities take place in every time zone. This worldwide reach enables the Federation to function as the key international forum for considering legislative, regulatory and other issues of interest to the global banking industry. For more information visit: www.ibfed.org

Since the leverage ratio is a non-risk-based measure, it could change the way affected banks deploy their capital, leading to potential changes in pricing and supply of low risk lending that supports the smooth functioning of the financial system. The leverage ratio should remain a backstop and not be binding for the majority of banks. Otherwise, there could be a shift towards riskier assets.

We understand that the Basel Committee seeks to recalibrate the leverage ratio based on a quantitative impact study (QIS) of the proposals. The overall calibration is key to determining whether the leverage ratio will become the binding constraint. As a result, we urge the Basel Committee to consult on these changes again, if possible, after considering preliminary comments and the results of the QIS.

Below we provide some high level messages on the consultative document.

I. Treatment of Derivatives

Adoption of a modified version of the standardised approach for measuring counterparty credit risk exposures (SA-CCR)

The IBFed is supportive of the adoption of a new non-internal model method for measuring counterparty credit risk exposures, which aims to replace the Current Exposure Method. The main purpose of SA-CCR is specifically to benefit from a better recognition of collateral that reflects more legal netting arrangements. Accordingly, the IBFed does not understand the Committee's rationale of revising its SA-CCR by limiting the recognition of collateral for the leverage ratio. We believe it is important to take into account the non-cash collateral as more and more counterparties will now have to post collateral and some of them can only rely on non-cash collateral (e.g. pension funds that do not have cash). We request the Basel Committee to take account the risk mitigating benefits of high quality liquid asset (HQLA) securities, which do not represent any liquidity risk.

In addition, we are concerned that the proposed modified SA-CCR change would 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 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.

We would also 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 IBFed 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.

Impact assessment on the client clearing business model

The IBFed encourages the committee to recognize initial margin received for client clearing activities. Without recognition there will be (and we are already observing) a massive exodus of client clearing actors even though in the European Union the central clearing regulation already requires generalization of central clearing via qualifying central counterparties (QCCPs). This could in turn, increase systemic risk on some very large clearing members.

Clarification on the currency of settlement criterion associated with the eligible cash variation margin (CVM)

The IBFed is concerned about the CVM haircut proposed by the Committee where the currency of the CVM does not match the termination currency of the netting set. We believe the proposed approach would add undue operational complexity to the leverage ratio framework.

We do not believe that an FX haircut for 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 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 master netting agreement (MNA)/ credit support annex (CSA).

Revisions to the specific treatment for written credit derivatives

We believe that the term "written credit derivatives" needs to be clarified such that only those derivatives that contribute to the leveraged amount meet the requirements in paragraph 191 to 193. We believe that the purpose of the Basel Committee is not to capture all credit derivatives but only where *“a bank sells protection using a credit derivative.”* The scope of credit derivatives that contributes for their nominal amount to the leverage exposure should be consistent with credit derivatives that qualify as a credit protection from a prudential standpoint. We firmly believe that such an alignment is meaningful and necessary as it would

both permit the achievement of the Committee’s goal and ensure a consistent implementation between credit institutions.

II. The treatment of regular-way purchases and sales of financial assets

The IBFed has a strong preference for Option B. We believe Option A would produce a distorted view of a bank’s leverage ratio denominator by over counting the Exposure Measure during the period between trade and settlement. The offset permitted in Option B reflects the reality of how the bank’s balance sheet will look after pending trades settle, and therefore prevents the over-count. Option B also recognizes the very temporary nature of any exposure sought to be captured (given the short period between trade and settlement). Further, it recognizes that without such an offset there would be large day-to-day swings in the balance sheet and leverage exposure for any bank that engages in a substantial amount of securities trading activities.

The IBFed, 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.

Lastly, 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 IBFed 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.

III. Revisions to the treatment of provisions

The IBFed is supportive of the proposed changes deducting general and specific provisions from the Exposure Measure. Given the overall objective of the leverage ratio, to mitigate the procyclical effect of the regulatory measures on bank’s activity, we consider of the upmost importance that on- and off-balance sheet items must be accounted on the Exposure Measure by their net value (i.e. after provisions).

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

The Committee’s desire to align the leverage ratio treatment of off-balance sheet exposures with the risk-based framework is not consistent with its intention to make the leverage ratio a “backstop” measure to the risk-based framework. A Credit Conversion Factor (CCF) for the leverage ratio should be lower than that for the risk-based framework. Also, we believe that proposed changes to the risk based framework are overly conservative and would lead to significant increase in capital requirements. Specifically:

- We believe the requirement that a Credit Conversion Factor (CCF) must be greater than 0% regardless of the exposure type is overly conservative. We also believe this

does not achieve the goal of correctly quantifying the risk associated with the lending product.

- For retail unconditionally cancellable commitments (UCC), the increase in CCF from 10% to 20% contemplated in the second draft of the BCBS's proposal does not reflect the significantly lower underlying default risk and unduly provides increased risk weighting on those individuals who utilise little or none of their credit limit.
- We also believe that the range of 50 – 75% for non-retail UCC is overly conservative as it does not reflect the actual usage ratios of these credit lines and would adversely affect lending and economic growth. Furthermore, the introduction of this approach would mean that there is little to no difference in capital requirements between the cancellable and non-cancellable commitments and the banks will receive very little capital relief from making a commitment cancellable. We believe there are good reasons why a commitment is judged to be unconditionally cancellable as it puts the bank in a better position to manage its risks, which should be recognised in reduced capital requirements. For product types that truly allow the bank to cancel uncommitted facilities at any time in practice, we believe that it is reasonable to apply the lower CCF proposed for retail UCC to non-retail exposures where there are demonstrated controls and legal rights, monitored with robust internal bank governance processes.

V. Treatment of cash pooling transactions

The IBFed believes that 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 ratios. 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 they are 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 have 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.

VI. Additional Basel III leverage ratio requirements for Global Systemically Important Banks (G-SIBs)

The consultation seeks views on the characteristics for an additional G-SIB requirement in order to propose a minimum global standard for leverage, comparable to the risk-based G-SIB capital framework. Our understanding is that this is based on the same logic applied by

certain local competent authorities – to keep the leverage ratio as a meaningful backstop to the risk based G-SIB measure for large banks. We feel that whilst this is in some ways a logical argument to advocate for an additional leverage requirement for G-SIB's, it is important that the BCBS considers the appropriateness and calibration of such buffers.

We strongly suggest that the BCBS should continue setting reasonable minimum standards that are appropriate for all major markets. Therefore, the BCBS should take into account divergent regional financing structures and bank balance sheet compositions and only apply G-SIB leverage ratio buffers if the QIS data indicates that the leverage ratio does not perform its role as a meaningful backstop across jurisdictions, and if such buffers can be applied without significant damage to broader markets and availability of key financing products.

VII. Treatment of traditional securitisations

Here also, we welcome that the Committee is working on further clarification regarding the treatment of traditional securitisations in the leverage ratio. Nevertheless, IBFed members would like to stress the following areas of concern:

- We believe that all traditional securitisation tranches sold to investors should reduce the leverage ratio since investors have no recourse to the originator bank, and thus these tranches should not be classified as bank liabilities for purposes of the leverage ratio calculation.
- Indeed, the business case to sell securitisations to investors is significantly weakened if they cannot subsequently be excluded from the calculation of the leverage ratio.
- If the above is not acceptable, at the very least, all securitisations that achieve Significant Risk Transfer (SRT) for regulatory purposes should be excluded from the calculation of the leverage ratio, even though for accounting purposes they might remain on balance sheet. In this case, the originator would only recognise for leverage ratio calculation purposes the nominal value of any retained tranches.

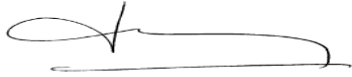
VIII. Unintended consequences to legitimated business models

A stated purpose of the leverage ratio is to avoid contributing to the vicious cycle of “fire sales” of certain types of assets during periods of market stress. Cash does not fall into this category; to the contrary, in times of economic stress, customers tend to flood the banking system with deposits rather than deploy their resources in riskier assets. This can cause significant volatility in on-balance sheet assets, including for custody banks that maintain the primary operational accounts of institutional investors with large and diversified global investment portfolios. Banks have little control over when customers choose to deposit cash rather than invest in other assets, and the leverage ratio should not penalise banks for conducting this core banking function. The leverage ratio should allow for banks to manage unpredictable spikes in customer deposit activities without having to resort to potentially destabilizing actions, such as the restricting of payment flows or a refusal to accept cash deposits.

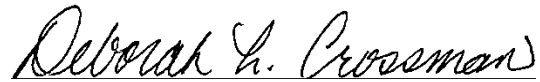
Conclusion

We thank you for taking our comments into consideration, and we look forward to future discussions on these issues.

Yours faithfully,



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IBFed



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