BCBS - Consultative Document; Revisions to the Basel III leverage ratio framework

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the consultative document on revisions to the Basel III leverage ratio framework and would like to submit the following position:

The Leverage Ratio (LR) aims to restrict the building up of leverage in the banking sector to mitigate the risk of destabilizing deleveraging processes which can damage the financial system and the economy. The objective is to introduce additional safeguards against model risk and measurement errors by supplementing the risk-based measure with a simple, transparent, independent “backstop” approach. In contrast to that the LR in its present design does not act as a second, independent safety-net that intervenes when risk-based capital requirements fail. Far more it is a different variation to calculate (additionally binding) own funds requirements. Against this background the Leverage Ratio should be introduced as a Pillar 2 requirement, as this allows a flexible implementation of the LR.

If banks become constrained by a measure of capital adequacy that does not differentiate between low and high risk assets, it will fundamentally change the way banks allocate capital to business lines, with subsequent changes to pricing and availability of products that are vital to functioning of the global economy. Additionally, should the LR be calibrated in a way that divorces binding capital constrains from risk, it would create incentives for banks to reallocate capital to higher yielding and riskier assets in an effort to generate shareholder returns. While regulatory requirements such as the LCR and NSFR mandate the holding of substantial quantities of low-yielding assets, these assets are “taxed” through the LR.

A stated purpose of the LR 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 and on the contrary, in times of economic stress, customers tend to flood the banking system with deposits rather than deploy their resources in riskier assets. Banks have little control over when customers choose to deposit cash rather than invest in other assets. The LR should allow for banks to manage unpredictable spikes in customer deposit, particularly if they deposit the funds directly at central banks. Otherwise, if banks are bound by the LR, they
may have to resort to potentially destabilizing actions, such as the throttling of payment flows or a refusal to accept cash deposits. Similarly, cash and high quality government bonds are used as collateral by most market participants for central clearing and other financing transactions and as liquidity reserves by small and large banks, investment funds and corporates. They play a critical role in the smooth functioning of financial markets. If market participants’ ability to generate liquidity through these assets is impaired due to constraints on bank balance sheet capacity, particularly during stress periods, it will have ramifications for the functioning of financial markets.

1. Credit conversion factors for off-balance sheet items

According to the current framework for leverage ratio in European Union, Commission Delegated Regulation (EU) 2015/62, the off-balance sheet exposure is calculated using the credit conversion factors (CCFs) of the standardized approach for RWA-calculation for credit risks of 0%, 20%, 50%, or 100%, depending on the risk category, subject to a floor of 10%.

The current approach is the result of amendments of the Regulation (EU) no 575/2013 and it came into force in January 2015. This change was considered a major change of the initial leverage ratio framework and it was highly appreciated by the banking sector.

According to the information provided in Annex II, points 8 to 14, the BCBS proposes a completely new methodology for the determination of the credit conversion factors. The proposed methodology would have at least the following implications:

- significant increase of the leverage ratio exposure for off-balance sheet items
- relevant investments required for the IT-implementation of the necessary changes

In particular, according to paragraph 13 of the Annex, the minimum credit conversion factors will range between 10% and 20% and it would be applicable only to the revocable undrawn commitments for retail customers. In this case, the financial institutions which have similar exposures with large corporate customers will notice a very significant increase of the leverage ratio exposure.

Additionally, it is worth to be mentioned that the proposed classification of the off-balance products on different credit conversion factors is not sufficiently clear and could conduct to different interpretations by financial institutions.

In order to assess the overall potential impact of the changes for credit conversion factors, there should be clear indication of the credit conversion factors applied. The range indications mentioned at paragraphs 10 & 13 in Annex II, respectively 50%-75% and 10% to 20%, do not support an overall impact assessment on the leverage ratio exposure.

2. Deductions of specific and general provisions from credit exposure equivalent amount

With regard to the paragraph 45 from Annex 1, the proposed methodology to reduce credit exposure equivalent amount by the specific and general provisions would have the following implications:

- non-significant reduction of the leverage ratio exposure
- additional costs for the necessary changes of the informational system
the proposed formula could generate “negative” off-balance sheet exposure in case that the credit exposure equivalent amount (off-balance exposure after application of credit conversion factors) is less than accumulated provisions

Our consideration is that the most effective approach would be to reduce the original exposure for off-balance sheet items with the correspondent value of the accumulated specific and general provisions. This solution would also be consistent with the current methodology applicable for standardized approach for RWA-calculation for credit risks.

3. Replacement of the current methods for calculation of derivative exposures

The consultative document proposes the replacement of the current methods for calculation of the derivative exposures, mark-to-market method (CEM) and original exposure method (OEM), by a modified SA-CCR (modified version versus COREP framework for RWA-calculation).

Due to the complexity of the SA-CCR method it has to be considered if there are important reasons for different SA-CCR methods for RWA and leverage, as this would additionally raise the complexity and costs for IT-implementation.

Furthermore our consideration is that the SA-CCR method would probably not be the most appropriate solution to be applied mandatorily to the financial institutions which do not have a significant portfolio of derivatives. An alternative method for calculation of the derivative exposure should be permitted by the framework (CEM or OEM).

We ask you to give our remarks due consideration.

Yours sincerely,

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