September 20, 2013

Comments on the Basel Committee on Banking Supervision's Consultative Document: Revised Basel III leverage ratio framework and disclosure requirements

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the consultative document: *Revised Basel III leverage ratio framework and disclosure requirements*, released on June 26, 2013 by the Basel Committee on Banking Supervision.

We hope that our comments below will be of assistance and offer an additional point of reference as you work towards finalizing the framework.

General Comment

○ Frequency of the leverage ratio calculation

We understand that, in discussing the frequency of the leverage ratio calculation, the Basel Committee on Banking Supervision ("BCBS") is seeking to prevent regulatory arbitrage in the leverage ratio requirements.

However, while increasing the frequency to require monthly calculation of the leverage ratio is highly unlikely to fulfill the BCBS's above intention, it will impose significant operational burden on bank's measurement practices and thus should be reconsidered. For instance, if the monthly leverage ratio calculation were to be required, a considerable number of tasks that are currently carried out on a quarterly basis (e.g. asset revaluation including self-assessment and intercompany eliminations) need to be conducted on a monthly basis, significantly increasing the burden of performing the calculation in practice. On the other hand, there still remains room for banks to manipulate the ratio using asset classes like short term prop trading positions which are not based on client needs and thus easy to change on a daily or weekly basis. As a result, this requirement will increase operational costs in financial institutions without achieving its regulatory objectives. In other words, the regulatory costs incurred by the requirements will largely exceed the expected benefits.

Therefore, in light of the above concerns, the leverage ratio should be calculated and disclosed on a quarterly basis, and asset classes which needs more frequent attention should be managed and monitored separately with appropriate scope and frequency from supervisor's standpoint based on the characteristics (e.g. product characteristics, purpose of holding, volume and volatility) of such asset class, risk management practices of banks and business practices in each jurisdictions.

○ Objectives and level of the leverage ratio

As described above, to prevent regulatory arbitrage in the leverage ratio requirements, supervisor's close monitoring with appropriate scope and frequency in accordance with the assets' characteristics will be necessary. In addition, as indicated by the BCBS, considering the difference in accounting frameworks, deposit insurance systems and the role and weight of commercial banking in each jurisdiction, it is not appropriate to impose a minimum level of the leverage ratio requirements across the board, which does not reflect risks. The leverage ratio should serve as a supplementary measure and should not be implemented as a Pillar 1 measure even in the future.

The BCBS proposes among other things in its Discussion Paper[1], a "buffer" structure for the leverage ratio. We disagree with the proposed buffer for the following two reasons:

1) Firstly, the reasonableness of the minimum leverage ratio of 3% has not been verified. Furthermore, since reaching agreement in December 2010, the scope of exposures to be included in the Exposure Measure (the denominator of the leverage ratio) has been expanding following the strengthening of regulations while the treatment of the Capital Measure (the numerator) has remained unchanged. This indicates that there is no reason and background that necessitates increasing the threshold from the 3% threshold, and rather, it may be necessary to reduce the current threshold.
2) If the minimum leverage ratio is raised, such elevated minimum leverage ratio may substantially serve as a minimum capital requirement, supplanting the risk-based capital ratios to be supplementary measures. In such a case, an improper incentive for banks to reduce low-risk assets and acquire high-risk assets may be triggered; moreover balancing between risk sensitivity, which the BCBS views as an important agenda, may not be fulfilled.

[1] BCBS Discussion Paper on The Regulatory Framework: Balancing Risk Sensitivity, Simplicity and Comparability, July 2013.

Specific Comments

○ Treatment of high quality liquid assets (HQLA)

Including in the leverage calculation central bank reserves which are permitted by the central bank to be withdrawn during a period of stress could undermine financial institutions' efforts to prepare for a crisis and moreover may limit the central bank's policy options. Similarly, including highly liquid instruments such as government bonds may give rise to incentives for banks to sell such government bonds to raise the leverage ratio, not only resulting in unnecessary market turmoil but also in conflicting with the objectives of liquidity requirements which intend to incentivise financial institutions to hold high-quality liquid assets. It is considered that there is no need to apply the leverage ratio requirements to cash and cash equivalents and it is not in line with the objectives of the requirements.

In this regard, and in order to achieve consistency across regulatory frameworks, HQLA and cash equivalents including central bank reserves should be excluded from the leverage ratio calculation.

○ Treatment of Securities Financing Transaction (SFT)

The Consultative Document describes in paragraph 35(ii) that a measure of counterparty credit risk calculated as current exposure should be added on to SFT assets. In the case of reverse repurchase agreements, however, the amount of risk is limited to SFT assets (e.g. receivables under resale agreements or receivables under securities borrowing transactions) recognised with no recognition of accounting netting. Even if the counterparty defaults, the maximum loss will be the amount recognised as SFT assets and there is no off-balance-sheet risk. Therefore, there are no reasonable grounds to include other exposures, such as counterparty risks, in addition to SFT assets, and such treatment should be avoided to prevent double counting of exposures.

Further, the calculation set forth in paragraph 35(ii) requires financial institutions to first identify the related collateral for each reverse repurchase agreement and then to calculate the current exposure. This will cause a considerable burden in practice that the associated benefits will not outweigh. In this regard, we consider that the current exposure associated with counterparty credit risk should be excluded from Total Exposures.

○ Timing of disclosure

According to the Consultative Document, the BCBS plans to carry out final adjustments to the definition and calibration of the leverage ratio in the first half of 2017. This indicates that a different definition and calibration may be applied after January 1, 2018. Disclosing the leverage ratios calculated based on an inconsistent definition and calibration before and after January 1, 2018 may cause unnecessary confusion to investors. Therefore, public disclosure should be commenced after the definition is finalised.

Further, given regulatory developments in the past, particularly when a new regulation is implemented, national supervisors will require approximately one year to legislate corresponding laws and regulations in their own jurisdictions after an international rule is finalised and at least an additional one year will be required for financial institutions to prepare for compliance with such regulations. Therefore, the lead time is considered to be insufficient for financial institutions to prepare for public disclosure starting January 1, 2015 taking into consideration the time left from the issuance of the final report up to the commencement date of public disclosure. Given this, the timing of public disclosure should be reconsidered, and until then the leverage ratio should only be subject to supervisory reporting.