EBA Banking Stakeholder Group

27 July 2012

European Banking Authority Consultation Paper on Draft Implementing Technical Standards on Supervisory reporting requirements for leverage ratio – CP 50 (EBA/CP/2012/06)

The EBA Banking Stakeholder Group welcomes the opportunity to provide our responses to the EBA consultation paper on draft implementing technical standards on supervisory requirements for leverage ratio.

Our reply is divided in two parts : one part with a general overview and one part with responses to the 16 questions outlined in the consultation.

Please do not hesitate to contact us for further discussions on these matters or if you like any further information or explanation.

Sincerely

Sony Kapoor
Chairman of the Banking Stakeholder Group

EBA Consultation Paper

on Draft Implementing Technical Standards

on Supervisory reporting requirements for leverage ratio

CP50 (EBA/CP/2012/06)

BSG comments and answers to listed questions

July 27th 2012

Introduction

The BSG welcomes the opportunity to comment the Consultation Paper 50 (EBA/CP/2012/06) on draft ITS on Supervisory reporting requirements for leverage ratio. This consultation paper has been discussed at the BSG July meeting and this paper has been prepared based on these comments and shared among the BSG members.

As for the CP50 on supervisory reporting requirements for institutions, the BSG supports the initiative that aims at harmonizing reporting across Europe in order to ensure fair conditions of competition between credit institutions and investment firms and more efficiency for cross-border institutions. The BSG also expects this initiative to facilitate data sharing between European supervisors and avoid reporting duplications for banks.

However, the BSG notices that the proposed ITS requires a much larger scope of data and a much more detailed level of information than the level 1 text in CRR. These requirements would inevitably result in both a significant implementation effort and a heavier reporting burden for banks, with additional costs, especially considering the requirement for monthly data to calculate the ratio. In this respect, the BSG questions EBA regarding its objective of reducing reporting burden and the objective of reducing administrative costs, as recommended by the European Commission.

The detailed answers to the CP are presented in the document attached, our main comments being summarized hereafter.

1. Implementation timeline

The LR reporting is a new requirement. Even if it relies as far as possible on existing accounting data, its production would imply changes in the systems mainly due to the granularity of the information to be reported, the frequency, timeline and scope of this reporting (individual and consolidated basis).

Moreover, taking into consideration that the CRD4/CRR final text has not yet been adopted, the BSG believes that the Q1 2013 deadline for the first new reporting is inadequate in terms of feasibility, comprehensiveness and quality and that the implementation date and the content of this ITS should be readjusted once the level 1 text is finalised and published.

2. Scope of reporting and deadline for remittance

As required by the level 1 text in article 5 of CRR, the CP is consulting on a reporting both on a solo and consolidated basis.

It should be considered that legal entity data is often problematic to produce for regulatory reporting purposes. The BSG believes that the leverage ratio should rather be reported on a consolidated basis or at least aligned with the scope of COREP, i.e. at the legal entity level only for the entities for which a COREP is currently required on a solo basis.

If it is eventually decided to provide some exemptions at a legal entity level, it would be better to do so now in order to avoid unnecessary compliance costs.

A realistic timeframe for consolidated reporting is also needed, as 30 business days seems to be challenging.

3. Calculation based on arithmetic mean of the monthly average ratio over a quarter

Many banks do not have all the data necessary for monthly calculation of leverage ratio, since neither COREP nor FINREP are requested on a monthly basis. Consequently, to produce these data on a monthly basis for the leverage ratio will require supplementary efforts for the institutions and we question the need to do so.

Furthermore, in article 475-3 CRR: « during the period from 1 January 2013 to 31 December 2017, competent authorities may permit institutions to calculate the end-of-quarter leverage ratio ». This provision might lead to differences of application between the member states and hence across internationally active financial institutions, which may lead to inconsistencies in the calculation of the LR for these institutions.

In order to reach a consistent result for the calibration and to enable the institutions to prepare themselves progressively, the BSG suggests having an uniform way for the calculation of the LR applicable to all the Member States and:

- even if the requirements of the level 1 text is a monthly average ratio over the quarter, to request the leverage ratio reporting only on an “end of quarter” basis, as for COREP and FINREP,
- alternatively, to request a leverage ratio reporting based on the end of the quarter figures during the first years and only afterwards to require it based on monthly averages, in order to give time to adjust the reporting lines to the new tasks.

4. Extensive data requirements

While the required data is extensive, the usefulness of the information is sometimes unclear and the BSG recommends EBA to provide explanations as to the benefit for regulatory and calibration purposes of the leverage ratio of some tables and to limit the requirements to such purposes, as well as avoiding duplication with existing regulatory reporting.

5. Other comments

- The consultation is only about reporting. However, the BSG believes that some feedback will be needed form EBA on the analysis of the results, with full appreciation of the different leverage that different but equally valid/cautious models can produce, in order to inform final decisions about its calibration and application.

- There is concern about the ratio having to be published from 2015 by the Banks while not finally calibrated (see Article 487.2 of CRR).

Consultation on CP 50 (EBA/CP/2012/06) - Supervisory reporting requirements for leverage ratio BSG detailed answers

Question 1:
Do institutions agree with the use of existing and prudential measures? Is there additional ways to alleviate the implementation burden?

The use of existing and prudential measures is a good proposal.

In order to reduce the implementation burden, Authorities shall rely on the existing regulatory reporting (COREP/FINREP) to get as much as possible data regarding the supervisory requirements for leverage ratio. Consequently, one way to alleviate the implementation burden would be to report only additional data not included in the other regulatory reporting.
Further action to alleviate the implementation burden would be that all or most of the memorandum items not used in actual leverage ratio calculations is excluded; at least the first couple of years. This information could instead be handled through dialogue with the national supervisors. One example of such a report is the LR6. An alternative solution is to require memorandum items only on consolidated basis.

It should also be noted that the prudential measures prescribed for derivatives and Securities Financing Transactions may not be consistent with measures used by institutions using advanced approaches and will need specific development to calculate this measures .

Finally, in the consultative paper states that “the reporting is as far as possible based on existing accounting and prudential measures already used for determining own funds and minimum own funds requirements”. However, it is worth noting that the IFRS standards will be subject to some changes that are not yet fully stabilized.

Question 2:
Do institutions already have the data required for reporting under this proposal available on a monthly basis?
If so, is the data of the required standard similar to other data reported to supervisory authorities?

Many banks do not have all the data necessary for monthly calculation of leverage ratio since the accounting and prudential reporting are performed on a quarterly basis. As a reminder, as of today, neither COREP nor FINREP are requested on a monthly basis and institutions do not have the data required for reporting on a monthly basis, including audited accounting data.

Producing these data on a monthly basis would therefore certainly require costly efforts for the institutions. Indeed, introducing monthly calculation requirements will have a huge impact on the reporting process as it requires involvement of different functions in the bank in terms of accounting data (balance sheet data), group credit data (provisions for shortfall calculation in the capital base,) as well as capital adequacy data.
In addition, it would be worth clarifying which specific data should continue to be monitored on a monthly basis starting from 1 January 2018.

Furthermore, in article 475-3 CRR: « during the period from 1 January 2013 to 31 December 2017, competent authorities may permit institutions to calculate the end-of-quarter leverage ratio ». This provision might lead to differences of application between the member states and hence across internationally active financial institutions, which may lead to inconsistencies in the calculation of the LR for these institutions. The calculation of the LR on a monthly average could be very different of the LR at the end of the quarter and therefore the calibration of this LR based on the observation period might be difficult to set-up.

In order to reach a consistent result for the calibration and to enable the institutions to prepare themselves progressively, the BSG suggests having an uniform way for the calculation of the LR applicable to all the Member States and:

- even if the requirements of the level 1 text is a monthly average ratio over the quarter, to request the leverage ratio reporting only on an “end of quarter” basis, as for COREP and FINREP,
- alternatively, to request a leverage ratio reporting based on the end of the quarter figures during the first years and only afterwards to require it based on monthly averages, in order to give time to adjust the reporting lines to the new tasks.

Question 3:
The same timelines are proposed for reporting on a consolidated level as well as on an individual level, is this seen as problematic? If so, would you propose a different timeline for reporting on a consolidated level?

As required by the level 1 text in article 5 of CRR, the CP is consulting on a reporting both on a solo and consolidated basis.

Due to the short timing to produce this reporting, it would be problematic for institutions to submit consolidated and individual data under the same timeframe. In order to ensure the reliability of the reported data, it would be advisable to provide a different timeline for reporting on a consolidated level. In this regard, the requirement to report the consolidated Leverage Ratio under 30 business days will be challenging.

Moreover, considering the postponement of the CRD IV approval by the European Parliament, the timing proposed to produce the first reporting seems inadequate.

It should also be considered that legal entity data is often problematic to produce for regulatory reporting purposes. The BSG believes that the leverage ratio should rather be reported on a consolidated basis or at least aligned with the scope of COREP, i.e. at the legal entity level only for the entities for which a COREP is currently required on a solo basis.
If it is eventually decided to provide some exemptions at a legal entity level, it would be better to do so now in order to avoid unnecessary compliance costs.

One way to do so would be to consider, in addition to the threshold based on the volume of derivatives, a more global threshold for the entity itself, based for example on the total size of the bank and its weight in the banking system.

Question 4:
What additional costs do you envisage from the proposed approach to reporting the leverage ratio in order to fulfill the requirements of the CRR outlined in this ITS?

The Leverage Ratio reporting is a new requirement. Even if it relies as far as possible on existing accounting data, its production would imply additional costs, mainly due to the adaptation of the systems. The main impacts would be linked to :

- granularity of the information to be calculated, verified and reported,
- frequency,
- timeline and scope of this reporting (individual and consolidated basis).

The proposals on derivatives will need careful testing. While there are carve-outs for the very small exposures, which the BSG supports, the costs for providing the information for other firms shall be estimated.

Moreover, some information requested are not needed for the calculation of the LR ratio and lead to additional costs:

- 5 out of 8 parts in the LR template are related to information that is not directly needed for the calculation of the ratio. Even though BSG recognizes that this additional data in the memorandum items are stated to be needed for the future calibration of the leverage ratio, it is clear that the extra reporting will be very time consuming and enhance the reporting burden substantially.
- institutions applying the IRB approaches would also have to produce information based on the standardised approach according to the CP 50 (see LR 5 : alternative decomposition of LR exposure measure components). This proposal would actually significantly increase the LR reporting costs as that would lead to have 2 lines of production of data and double reporting for derivative and credit exposures for banks with IRB and IMM approvals.

It is worth noting that this requirement is a material change to the CRR provisions that is currently submitted to the European Parliament and Council. As a general principle, the BSG suggests clarifying what will be the use of the data not needed for the calculation of the LR and the corresponding CRR provisions.

Questions from Annex II:

Q5: Is the calculation of the derivatives share threshold sufficiently clear?

The Consultative Paper has introduced the principle of the proportionality regarding the reporting requirement which is exclusively based on the volume/size of the derivatives and the credit derivatives of the entity. Two thresholds have been established regarding the requirement to report or not data for derivatives. The thresholds levels are calculated by dividing the leverage ratio exposure value for derivatives by the leverage ratio total exposure measure. It is proposed that a threshold range for derivatives reporting should be within range of 0,5% to 2,0%. A similar threshold has been proposed on credit derivatives reporting. This threshold is imposed on nominal amounts and is proposed to be set in the range from 200 M€ to 500 M€.

The threshold regarding derivatives reporting is not clear. For example the threshold is based on mark-to-marked method and not the bank's approved method for calculating derivative exposure (see Q4). We also observe that {LR2;070;5} is deducted twice in the total exposure measure formula which is assumed to be a typo. Furthermore, in the total exposure measure formula the link is unclear regarding 20% and 50% CCF as only 10% CCF is applied. It will be also necessary to clarify why the split between the standardised approach CCF classes is needed if not separately considered in the calculation of the total exposure measure in leverage ratio.

Finally, it is not clear whether the credit derivatives data have to be reported if the derivatives volume is below the first threshold of 0,5% to 2%. As far as the threshold allows institutions to limit the detail of their reporting on derivative, we believe that the threshold should be determined consistently with the degree of reporting adaptation involved.
When an entity is below the threshold, it does not need to report details on their credit derivative exposures separately from their other derivative exposures.
As a consequence, we propose that the threshold is based on the proportion of credit derivatives out of the total derivative exposure.

Q6: Do you believe this method captures institutions derivatives exposure in a sensible way?

BSG considers that this method does not reach its objective because the method for calculation of derivative exposures in leverage ratio should follow the same approval the bank uses in the rest of the capital adequacy reporting (please refer reply to question 5).
Furthermore, it would have been very useful to rely on other existing reporting (FINREP, COREP) to capture this information and request only useful additional infor-

mation. It will be also useful to set-up cross-check with the other existing reporting which provide global information (FINREP more particularly).

Q7: Does the reduction of fields to be reported in a given period by institutions that do not exceed the threshold value in that period, lead to a significant reduction in administrative burden?

Except the reporting LR7, all the other reporting include not only data about derivatives but also other data such as the LR1 and LR2. In order to reduce the reporting burden it would have been for instance useful to isolate information regarding the derivatives in dedicated reporting. Also the threshold is based on mark-to-market method which will be not relevant for banks applying IMM approval.

Q8: Preliminary internal calculations by supervisors suggest that a threshold value should be in the range of 0.5% to 2%. Would you suggest a different threshold level, if yes, please justify this?

The threshold value seems to be based on the Basel III-monitoring exercise which charted the ratio of leverage ratio derivatives exposure to total exposure and should be therefore realistic and meaningful. However, as mentioned in previous sections, the main concern is how to calculate the derivative share. It seems that the level is too low given the method used, i.e. mark-to-market. For the banks having approved models, to be allowed, as in the Basel III QIS, to use these models as the basis for calculation, would reduce the reporting burden and the threshold values would be more relevant.

Q9: Is the calculation of the nominal amount threshold sufficiently clear?

No, the calculation is not very clear in the paragraph 23 on page 3.

Do we need to sum all these amounts? If yes, why do we sum “accounting balance sheet value” and “gross value (assume no netting or CRM) for derivatives on-balance sheet items (see. LR. 1)? On the other hand another bank has interpreted the amount to be reported as the netted amounts in LR4 column 1. It will be necessary to clarify what is supposed to be reported in this template.

Q10: Preliminary internal calculations by supervisors suggest that the nominal threshold value should be in the range of 200 to 500 million. €. Would you suggest a different threshold level, if yes, please justify this?

The threshold value seems to be based on the Basel III-monitoring exercise which charted the ratio of leverage ratio derivatives exposure to total exposure and should be therefore realistic and meaningful. However, it is not clear whether this threshold is relevant to identify institutions with important risks.

A suggestion could be to base the threshold on the banks' balance sheet size and not fixed amounts. Similar to the way the derivatives share is calculated with respect to total exposure measure the threshold could be a ratio instead of based on fixed nominal amounts (see Q5).

Q11: Is the term "reference name" and the distinction from "reference obligation" sufficiently clear?

These 2 notions exposed in §36 need more guidelines. It would be for instance necessary to add examples to the proposal.

In the LR5 "Capital and calculation of the leverage ratio", several cells refer to the CRR article 416-4. However, this article which specifically refers to the consolidation of significant investments in relevant entities is not sufficiently clear. In this regard, the BSG suggests that the reduction of the exposure measure should be more clearly explained, by adding the following details to the ITS:

- The calculation of the LR ratio is based on the prudential consolidation used for the COREP reporting;
- Paragraph (a) of Art. 416 (4) should be understood as "the sum of exposure values of all the assets either deducted or risk-weighted for the calculation of Tier-1 solvency ratios, relating to significant investments in relevant entities that are included in the consolidation according to the relevant accounting framework but not in the prudential consolidation according to Chapter 2 of Title II of Part One" ;
- Paragraph (b) of Art. 416 (4) should be understood as "the sum of the deductions from Tier-1 items specified in point (i) of Art. 33 (1) and in point (d) of Article (53) relating to relevant entities that met condition (a) divided by the sum of exposure values of all the assets either deducted or risk-weighted for the calculation of Tier 1 capital relating to relevant entities that met condition (a).

Q12: Is the treatment of credit derivatives referring to indices and baskets sufficiently clear?

The treatment of credit derivatives to indices and baskets is not sufficiently clear and needs more guidelines. It would be for instance necessary to add examples to the proposal.

Q13: Which additional contractual features should be taken into consideration when assessing offsetting of written and purchased credit derivatives? How would this add to complexity and reporting burden?

No observation.

Q14: Is the classification used in template LR6 sufficiently clear?

This template needs more guidance. Few cells are not explained in the text and it is difficult to populate it (for instance the split between “securities for securities financing transaction” and “of which repledged”). The column 2 requests RWA information for a classification existing under standard approach. For the banks applying IRB approach, it will request additional efforts to produce these data.

In addition, the definition of trading book exposure is not clarified in relation to market risk RWA, nor the treatment of CVA risk in this context.

Also, some further sections in LR6 that needs further clarification. For instance, for the rows 090 and 130 the instructions are missing ; for row 050 the definition is vague about the definition of “repledged”.

Furthermore, other errors can be found in Annex II. For example the calculation of leverage specified in annex II, paragraph 13 seems to be incorrect.

In the instruction for LR3 is it in § 30 stated that only the non-trading book should be included, while it in § 33 are written that also exposures within the trading book should be included in this template (even though the template includes the description: “Total on-and off-balance sheet exposures belonging to the banking book”).

Q15: Do you believe the current split, which is predominantly based on the exposure classes for institutions using the standard method are appropriate or would you suggest an alternative split?

This template is based on classification existing under standard approach and we understand that the second column asks for RWAs calculated under standard approach. For the banks applying IRB approach, such information is not available. BSG recommends the template to be split into two templates allowing reporting under standard and IRB approaches. In such case, LR6 will become a complete duplication of Corep where all the information is already currently available.

Filling in in this template is burdensome. For instance, the most problematic area is the breakdown into groups not used at all in the COREP report such as row 020, 030, 040, 050, 090, 110, 140 among others, since it demands the adjustments and analysis regarding the COREP report to be made on a much more detailed level. In some area this also put additional requirement on data delivery as well as on the used applications and processes, which in turn are connected to a higher implementation cost.

Q16: Is the classification used in template LR7 sufficiently clear?

This classification appears to be sufficiently clear. However, in the QIS, the reporting LR8 on “asset encumbrance” was not requested. ITS is not supposed to introduce new requirements which are not stipulated in the level 1 text. BSG recommends EBA to provide explanations as to the benefit for regulatory and calibration purposes of the leverage ratio of this table.