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European Banking Authority

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Subject	Consultation on revised ITS on supervisory reporting

Dear Sir, Madam,

The Dutch Authority for the Financial Markets (AFM) is pleased to provide feedback on the consultation by the European Banking Authority (EBA) on revised Implementing Technical Standards (ITS) on supervisory reporting.

Although the revised reporting standards have a microprudential character, they have an impact on the well-functioning of capital markets, in particular on the European repo market. As capital market supervisor, it is our view that such capital market considerations should be taken into account when designing financial regulation. Against this background, we hereby share our ideas on the reporting requirements for the leverage ratio (point 63 to 66 in the consultation).

AFM view

It is currently proposed to only include securities financing transactions (SFTs) of banks in the averaging requirement of the leverage ratio. Whilst supporting averaging requirements for SFTs, the inclusion of additional components of the leverage ratio in this averaging methodology may be warranted.

The AFM supports the initiative to perform an analysis assessing the significance of each component of the leverage ratio on intra-quarter volatility of this ratio and how crucial it is, as set out in point 65 of the consultation. This analysis should also include the impact that components of the leverage ratio have on the well-functioning of capital markets, notably the repo market. Following this analysis other components should be considered for inclusion in an averaging requirement if warranted.

Background

A well-functioning repo market is of great importance to the European financial system, as it is essential for the liquidity management of institutional investors and banks. In recent years, however, the European repo market has been under pressure at the end of each quarter and especially at year-ends. A potential important reason, although not the only one, for this periodic effect could be the current way in which banks report their leverage ratio to banking supervisors.

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European banks are currently required to report the leverage ratio as measured at the end of each quarter. As a result of this snapshot measurement method, European banks can limit capital costs of repo transactions by leaving the repo market at reporting dates. By doing so, banks can report a higher leverage ratio than their quarterly average. Already in October 2018, the Bank of International Settlements argued that this method gives rise to window-dressing behaviour by banks with respect to the leverage ratio.[1] The peaks in European repo rates and the demise of liquidity around reporting dates, can therefore potentially be explained by banks withdrawing from the repo market at these dates.

To reduce quarter- and year-end effects in the repo market, it is important to change the reporting method for the leverage ratio from the current quarter-end snapshot to an average. The current EBA-proposal is therefore a step in the right direction. However, because the current proposal only includes SFTs in the averaging methodology, many components of the leverage ratio are still excluded. Including additional components in the averaging methodology, as is already the case in the UK and the US, may contribute to better functioning markets. These components for instance may include "central bank reserves" and "derivatives".

Since 2017, U.K. banks are required to report the daily or monthly[2] average of the leverage ratio. Research[3] shows that the quarter-end effect in the U.K repo market have decreased since the introduction of this averaging requirement. Likewise, U.S. banks are required to report the daily or weekly averages on many components of the leverage ratio. As a result, these banks are more continuously present in the U.S. repo market than European banks. Although there have been disruptions on the U.S. repo market in recent months, these are caused by factors not related to the averaging requirement.

To conclude, the AFM sees the current EBA-proposal on averaging of the leverage ratio as a step in the right direction, but further steps may be warranted if this is supported by the analysis. Other countries, notably the U.K. and U.S., have already shown that banks are capable of reporting frequent averages of multiple components of the leverage ratio and that this helps to improve liquidity in the repo market.

We are available for further discussion on our view on the impact of the leverage ratio on the repo market.

Yours sincerely,
The Dutch Authority for the Financial Markets

Gerben Everts
Member of the Executive Board

[1] See BIS statement on leverage ratio window-dressing behaviour https://www.bis.org/publ/bcbs_nl20.htm
[2] Daily reporting applies to on-balance sheet assets and monthly reporting to off-balance sheet assets.
[3] Kotidis, A. and N. Van Horen, 2018, "Repo market functioning: the role of capital regulation", Bank of England, working paper.