Press release

GFMA, IIF, ISDA, JFMC and TCH respond to the Basel Consultation on Leverage Ratio

July 7, 2016

London – July 7, 2016: The Global Financial Markets Association (GFMA), the Institute of International Finance (IIF), the International Swaps and Derivatives Association (ISDA), the Japan Financial Markets Council (JFMC) and The Clearing House (TCH) today responded to the Basel Committee on Banking Supervision's (BCBS) consultation on *Revisions to the Basel III leverage ratio framework (Proposed Framework).* The full response is available here.

The Associations continue to support the BCBS's efforts to create a simple, transparent and non-risk-based backstop to the risk-based framework. They also commend the BCBS for consulting on various issues that improve the harmonization of the exposure measure and take into account developments elsewhere in the regulatory agenda. However, the Associations strongly encourage the BCBS to expand the scope of the review and carefully consider the way cash and unencumbered cash-equivalent assets are treated in the leverage ratio.

On July 5, the Bank of England's Financial Policy Committee published a review of the leverage ratio framework in its Financial Stability Report, and expressed strong concerns regarding the inclusion of central bank cash balances in the leverage ratio. The Associations share the FPC's concerns that including central bank deposits in the leverage ratio can affect the ability of the banking system to cushion shocks.

The Associations also highlight in their response that the BCBS should consider how other cash-equivalent securities, such as US Treasuries and other high-quality government bonds, are treated in the leverage ratio and the broader Basel framework. These securities underpin the soundness of the financial system and are used as collateral by most market participants for central clearing and as liquidity reserves by all banks and other market participants. If banks are bound by the leverage ratio, they cannot provide financing, even against such high-quality assets, and this may significantly reduce risk warehousing capacity on a system-wide level.

Kenneth E. Bentsen, Jr., chief executive officer, GFMA, commented: "Even client transactions that are designed to reduce risk will require broker-dealers to expand their balance sheets. Regulations should not impair clients' ability to conduct risk-reducing transactions in cases where these transactions do not add risk to banks' balance sheets. By excluding cash and cash equivalents from the exposure measure of the leverage ratio, regulators could alleviate the constraints on these important market activities, especially in distressed markets."

"The leverage ratio is an important part of the overall Basel capital framework, and it should remain a meaningful backstop measure as originally intended," said Tim Adams, president and CEO, IIF. "We are concerned that, unless properly designed, the leverage ratio may become the binding capital constraint for an increasing number of firms. It is vital that the leverage ratio is calibrated in a way that does not constrain efficient financing for economic growth and job creation."

"The leverage ratio as it stands makes the economics of client clearing extremely difficult for clearing members, which runs counter to the objective set by the Group-of-20 nations to encourage central clearing.

We welcome the decision by the Basel Committee to collect data to study the impact of the leverage ratio on client clearing, but we are disappointed it has not taken the opportunity to consult on the recognition of initial margin more widely," said Scott O'Malia, ISDA's chief executive.

"The proposed changes in credit conversion factors must be recalibrated so that they align with recent credit experience and do not severely limit the availability or cost of the associated loan commitments for retail and wholesale customers including small businesses and thereby hinder the nascent global economic recovery," said David Wagner, executive managing director, The Clearing House.

Against these broader concerns, the Associations' response sets out in detail the recommendations and changes they consider necessary so that the leverage ratio framework captures real leverage without damage to functioning of financial markets. Among others, they make specific recommendations regarding the trade versus settlement date accounting proposals, cash pooling, calibration of credit conversion factors, and treatment of securitizations and derivatives.

The Associations recommend that the BCBS adopts option B on netting for unsettled regular-way purchases and sales of financial assets. The proposed option A would produce an artificial 'ballooning' of the bank's balance sheet and increase volatility in the exposure measure depending on the volume of client transactions. The only way for a bank to manage this exposure would be to constrain execution of client orders. This would be an undesired outcome with a significant impact on broader market liquidity, while not addressing a real leverage concern. Delivery-versus-payment settlement ensures that, at all times, the bank has either the security or the cash associated with buying or selling that security.

The Associations object to proposed changes to the treatment of notional pooling arrangements, in cases when the pools achieve a single unit of account treatment under accounting rules. These are key cash management products for large corporates that provide products and services to the real economy. They benefit from notional pooling due to reduced liquidity management and operational burdens. If this accounting concept is not recognized in the leverage ratio, clients that use these structures would have to absorb higher operational costs or fundamentally change how they operate and manage cash.

The Associations welcome the BCBS's decision to consider recognizing the exposure-reducing effect of initial margin in client clearing transactions, as properly segregated initial margin posted by a counterparty is not a source of leverage and risk exposure for a bank. However, the industry expresses concern that the BCBS chose not to consider the issue of whether to recognize collateral posted by counterparties on derivatives trades more broadly. The Associations also highlight the fact that the lack of recognition of high-quality liquid assets as variation margin will potentially limit the access to derivatives of pension funds and other end users that rely on the ability to post securities collateral.

The Associations also note that a well-calibrated leverage ratio that recognizes the benefits of securitization for originating banks can be both prudent and help meet global and regional policy objectives of reviving the securitization market in order to support growth and the real economy. Where a bank securitizes assets in a traditional securitization and sells tranches to third-party investors, without recourse to or repurchase obligation by the bank, the bank should be permitted to exclude those assets from its leverage ratio.

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About GFMA:

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

About IIF:
The Institute of International Finance is the global association of the financial industry, with close to 500 members from 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks. For more information visit www.iif.com.

About ISDA:
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.
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About JFMC:
The Japan Financial Markets Council (JFMC) is an association which includes representatives from five Japan-based institutions and five international firms active in Japanese capital markets. Its aim is to ensure that authorities deciding on regulatory initiatives that have a global impact are aware of and take into account the effect of new regulations on Japanese capital markets. For more information: http://www.japanfmc.org/

About TCH:
The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Payments Company L.L.C. owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. Its affiliate, The Clearing House Association L.L.C., is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system.