UK FINANCE

A response to the
the FPC and PRA's CP 14/21 consultations on

Changes to the UK leverage ratio framework

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to FPC and PRA's consultations (CP) proposing changes to the leverage ratio framework and its implementation. The proposal to increase the scope of the leverage ratio will impact all of our members, both in its own right but also because of its potential influence on other prudential metrics such as minimum requirement for own funds and eligible liabilities (MREL). This response reflects the views of all our members, be they G-SIBs or other systemically important banks, mid-tier and challenger banks or smaller building societies.

Key Messages

Our members broadly support the intentions of the FPC and PRA's proposals which are to update the UK's leverage ratio regime to reflect further international developments. This will ensure the UK's regime is aligned with international standards. Our members fully support a harmonised, proportionate approach, to the implementation of internationally agreed standards.

We also recognise the benefits to financial stability of ensuring that all banks and building societies are subject to similar prudential standards and welcome the expansion of the scope of the leverage ratio regime to non-systemic firms as a supervisory expectation, rather than a hard requirement, as this formulation avoids consequent knock-on impacts on MREL requirements.

We note however that the application of the leverage ratio requirement to firms without retail deposits will subject them to a higher requirement, potentially distorting competition between the largest banks depending on their funding model. We recommend that firms are able to opt out of the Central Bank claim exemption enabling them to remain on the 3% leverage ratio requirement.

Please find below our comments on the issues arising from the CP.

Scope

(i) Level of application

As we understand the CP, if a firm meets any of the thresholds at the solo-level, they will automatically be in scope for the leverage ratio.

As set out in paragraph 10.7 of the PRA consultation "*an RFB which is the ultimate parent entity within a sub-consolidation group will not be subject to an individual requirement, if it meets the threshold on an individual basis"*. This is implemented by Paragraph 2.1 of "*the Draft amendments to Supervisory Statement 'The UK leverage ratio framework'"*[1] and is consistent with the FPC's proposed direction. However, this does not address the situation where a ring-fenced sub-group is headed by a holding company; in this situation the leverage ratio would apply both at the sub-consolidated level and at the level of any subsidiary firm in a subgroup that individually meets one of the thresholds. This rule appears to give rise to an incremental requirement for these firms, purely on the basis of their corporate structure, to which the leverage ratio should be blind.

The PRA also proposes to allow application on a sub-consolidated basis as an alternative to an individual requirement on a case-by-case basis, subject to PRA permission. However, the conditions placed around the granting of any application are such that they would not enable the individual application of the requirement to be replaced by the sub-consolidated requirement at the ring-fenced sub-group level. The nature of the oversight and governance of a ring-fenced subgroup means that leverage and capital are managed at the level of the subgroup including any subsidiaries; there is a governance structure in place at the level of the ring-fenced holding company which covers the subgroup. It is not clear that this derogation would be applicable for sub-consolidations headed up by a holding company and the requirement that it would only be applicable for subsidiaries (rather than those also including participations) means it would not in all situations be able to be applied at the level of ring-fenced sub-group.

Our proposal is therefore that the PRA extend the permission process to disapply the individual requirement where a firm that meets the threshold is contained within a ring-fenced sub-group. In this situation the firm would still be subject to the pillar 1 requirement at the sub-consolidated level and the PRA would receive detailed reporting on leverage at the firm level for relevant entities within the subgroup.

---

[1] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2021/june/cp1421app2.pdf

(ii) Applicability to foreign assets

Our members would welcome more information on the economic justification for the expanded scope for firms with more than £10bn of non-UK assets, for example, how the economic risk that these firms represent was determined and how it relates to the £50bn threshold for large UK retail firms.

The CP mentions the desire for this new threshold to capture major international investment firms. However, we note that credit institutions with less than £50bn of retail deposits but with non-UK assets above £10bn are also captured. The large difference between the two thresholds will disproportionately impact these smaller banks.

We acknowledge the prudential objective to enhance the supervision of significant wholesale firms not captured by the current regime which relies on a retail deposit threshold. It is recognised that a comprehensive study has been performed based on historical data to understand the prudential impact of calibrating the non-UK asset threshold. However, such an approach does not sufficiently consider the ramifications for firms that could meet the threshold in the near future. We would encourage the PRA to also consider the policy implications for fast growing firms to ensure the regime continues to promote a dynamic and internationally competitive market, but more crucially, a proportionate approach that scales up regulatory expectation based on a variety of criteria beyond the quantum of non-UK assets (for example systemic importance).

In particular, consideration should be given to international banks active in the UK market. The current binary criteria framework could force small international firms into the regime. The cost to implement these requirements could place a disproportionate burden on firms which do not yet operate at the same size or level of complexity compared to others captured within the regime. This could have unintended consequences, acting as barrier to growth and creating an uneven international playing field, where non-UK competitors might not be constrained by a similar regime. Drawing on reference to the simplified regime operated elsewhere such as the United States, banks are brought into additional requirements only when they reach $50bn of assets. We recommend that the non-UK asset threshold is increased and/or considers a multi-factor model rather than the current proposal to ensure that all firms captured in the regime are of a scale which requires extra supervisory oversight.

In addition, further detail on the calculation of the threshold as well as the form of averaging methodology is required. The latter is important to stabilise the determination of in-scope firms which can have seasonal variation in holdings of non-UK assets, while it is also important to ensure that by doing so, there is no additional operational burden on top of existing risk and capital management and reporting requirements.

Central Bank Exemptions

(i) Retail vs Wholesale funding models

The CP re-iterates that the purpose of the central bank claim exemption "*is to avoid a situation in which the leverage ratio framework impeded the transmission of monetary policy*". We support this, but there are some firms that will not be able to meet the required threshold to allow them to make use of the central bank exemption. Such firms do not have UK deposits and so do not actually contribute to the monetary policy transmission mechanism in the UK, as they fund themselves via the wholesale markets, thus they have a limited effect on the UK money supply.

Para 5.4 of the CP states:

> *"As a result of its 2016 review, the FPC increased the minimum leverage ratio requirement by 25 basis points, from 3% to 3.25% of total exposures, excluding central bank reserves. This was in order to ensure that excluding central bank reserves from exposure measure at the time did not reduce the amount of capital needed to meet leverage ratio capital requirements."*

Based on para 5.3, it is not clear to us why it is necessary to subject banks without central bank reserves to the additional 0.25% of leverage ratio.

In addition, para 5.4 states:

"*The FPC considers that this does not warrant a recalibration of the leverage ratio minimum. The resilience achieved continues to be that provided by the 2015 calibration, because of the uniquely risk-free nature of deposit-matched central bank reserves. Recalibrating the minimum now to match this increase would be opposed to the objective of the central bank reserve exemption, which is to avoid a situation in which the leverage ratio framework impeded the transmission of monetary policy."*

To overcome this effect, which risks competitive distortion, depending on funding model, we believe the most appropriate approach would be a "modification by consent" approach, enabling firms to continue to be subject to a 3% leverage ratio if they do not have sufficient retail deposits to offset.

(ii) Permanence of Central Bank exemptions

Our members very much welcomed the PRA's August 2016 announcement that subject to a modification by consent they could exclude central bank deposits from the leverage ratio calculation. This has been even more important as banks' central bank reserves have increased substantially over the period of the coronavirus pandemic.

We recommend that this central bank exemption should be made permanent or at least subject to a lengthy notice period should the FPC determine it wishes to withdraw it.

(iii) Definition of deposit funding

We would like to note that for the purpose of this response to CP14/21, we assume that deposit funding that is eligible to be offset against the central bank claims exemption is not explicitly limited to retail deposits – unlike the definition of deposits used in determining the threshold for which firms would be in scope of the proposals outlined in the CP. The threshold for capturing in-scope firms is defined in Para 1.18 (c) of the CP as 'all firms with *retail* deposits equal to or greater than £50 billion'.

However, Para 1.28 makes no such equivocation regarding the use of deposits eligible to offset the central bank reserve exemption. We note that, for the purposes of identifying a deposit as eligible for offset, the definition is taken from Part 2 of Annex II[2] in the ECB BSI regulations. This definition is amounts (shares, deposits or other), which are owed to creditors and:

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R1071

- Are transferable using payment facilities such as cheques, transfer orders, direct debits or similar means
- Are convertible into currency
- Have certainty of value.

We therefore understand that both commercial and retail deposits can be offset against reserves held at the central bank and would welcome this specific clarification in the final standard.

(iv) Maturity matching requirement

We support the exclusion of claims on central bank from the Leverage Exposure Measure (LEM). However, as noted in the FPC proposed direction to the PRA, paragraph 3.6, and hence PRA consultation Art. 429a, central bank claims (including reserves) can be excluded from the LEM, if their contractual maturity is less than the contractual maturity of the supporting deposits.

The capacity of emerging markets' central banks to raise long term liquidity is supported by their issuance of bonds. These bonds holdings are allowed to satisfy central bank reserve requirements. However, the bonds generally have longer tenors than some client deposits and so would not qualify for exclusion from the LEM. This would lead banks to shift their required reserves from bonds to deposits, hence hindering the capacity of emerging markets' central banks to raise long term liquidity and undermine the stability of the financial system.

We therefore propose that the maturity matching requirement should not be required for central bank bonds that meet reserve requirements. This would support emerging market economies which may find it more challenging to raise long term funding by underpinning our members' appetite for investments in such instruments.

Covid guarantee schemes

Loans under UK's Bounce Back Loans Scheme (BBLS) or to SMEs on the back of EEA government 100% backed Covid-19 guarantee schemes can be deducted from LEM. We believe this should be expanded to include jurisdictions outside of the EEA.

In a post-Brexit world, non-exclusively expanding this deduction to relevant Covid-19 support schemes in all countries would provide better support to the PRA's standing as an inclusive global banking regulator. Government backing of Covid-19 support schemes is widespread – limiting the permitted deduction only to small sized loans to SMEs understates the impact that scheme lending has had on banks' balance sheets. We therefore believe this deduction should be broadened to all Covid-19 government schemes regardless of loan size, borrower type and country, but only up to the extent of the percentage of government backing of these instruments.

Supervisory Expectations

We welcome the PRA's proposal that the application of the leverage ratio to non-systemic firms should be by way of a supervisory expectation, meaning that their leverage ratio should not fall below 3.25% in the normal course of business or as part of their base business plans. We welcome the acknowledgement that there may be occasions when an individual firm's leverage ratio may fall below this level and that if this does happen there will be no implied breach of Chapter 11 of the ICAA Part or of their ceasing to meet their Threshold Conditions. Our expectation is that in such circumstances, firms would engage with their supervisor to agree a remediation plan to return their leverage ratio to the 3.25% supervisory expectation.

SA-CCR in leverage ratio

(i) Derivative transactions

One of the anticipated consequences from the introduction of SA-CCR (and removal of IMM) in the UK is an increase in the exposure measure for derivative transactions, which will consequently impact leverage ratio calculations for UK banking entities. This has potentially larger impacts for some wholesale-oriented banks, who utilise global booking hubs located in the UK. They have a larger number of intra-group exposures put in place to manage back-to-back risk transfers, which will be disproportionately impacted by the change in the derivatives exposure measure. We encourage the PRA to consider these impacts in their review of the SA-CCR standard and its impact on the UK's reputation and continued competitiveness as a global financial centre consequences of losing its leading position in the derivatives market.

(ii) A principle to avoid double counting

More generally we note that the Basel Committee has taken a case-by-case approach to correcting such anomalies, which can give rise to double counting effects (e.g., settlement balance netting, EAD reduction for provisions etc). We suggest that the PRA should establish a 'principle' whereby demonstrable double counts within the accounting and/or regulatory frameworks, could be eliminated by the firm. For example, the approach that is now applied to unsegregated cash collateral should also apply to other forms of unsegregated collateral not in the form of cash, thus removing any double counting of collateral on balance sheet that are also used in the replacement cost term in SA-CCR.

(iii) Alpha Factor

The exposure measure for SA-CCR remains an issue. For leverage purposes, the exposure measure reflects the balance sheet value and not a risk value. As such, increasing the mark-to-market value by the alpha factor of 1.4 does not seem appropriate. We urge the PRA to consider the specific impact of SA-CCR on the exposure measure, and request that the alpha factor be removed from the leverage exposure calculation.

(iv) Definition of Net Independent Collateral Amount

The PRA Rulebook has defined Net Independent Collateral Amount (NICA) as "*the sum of the volatility-adjusted value of net collateral received or posted, as applicable, to the netting set other than variation margin*"

CRR Article 276(g) requires that "*any collateral posted to the counterparty that is segregated from the assets of that counterparty and, as a result of that segregation, is bankruptcy remote in the event of the default or insolvency of that counterparty shall not be recognised in the calculation of NICA*"

The Basel framework (CRE52.17) states that "*NICA represents any collateral (segregated or unsegregated) posted by the counterparty less the unsegregated collateral posted by the bank*" for the purpose of regulatory capital calculation.

Although there is no specific guidance on this question in current Basel leverage framework, a future version which will be effective from 1 Jan 2023 provides clarification that the relevant provision of using NICA only considers received initial margin (LEV 30.27):

‘For the determination of RC and PFE, the amount of initial margin received by the bank from its client that may be included in the values of C and NICA should be limited to the amount that is subject to appropriate segregation by the bank as defined in the relevant jurisdiction.’.

In the absence of clear definitions in the PRA Rulebook, we seek clarity on the exact components of NICA with respect to (i) initial margin and (ii) any other collateral, whether segregated or unsegregated, posted or received, and how they should be used for the purposes of calculating the replacement cost of derivative contracts within the leverage ratio framework.

(v) Excess collateral deposited with Tri-party agents

We ask the PRA to clarify how the institution should compute the excess collateral held at the tri-party agent that has not been lent out.

There appear to be three approaches:

Approach 1:

Should the excess collateral equal the entire account balance for securities held at the tri-party agent (which comprises the net sum of securities reversed-in less securities repo’d plus securities purchased less securities sold)? As such the balance on the account for a given close of business would be determined from data provided by the tri-party agent to the institution.

Approach 2:

Should the excess collateral equal the balance in the ring-fenced tri-party account with the tri-party agent? This is usually zero at each close of business, as securities entering the account are pre-destined for tri-party repos or reverse repos that are pre-agreed with the tri-party agent.

Approach 3:

Should the excess collateral be calculated on a trade-by-trade basis for the tri-party trades in question for a given close of business? If so, how and could the PRA please provide an example?

(vi) Written credit derivatives

In accordance with paragraph 3 of Article 429 (d) of the Leverage Ratio (Part Seven CRR) part of the proposed rulebook, the exposure value of written credit derivatives may be reduced by the notional amount of purchased credit derivatives subject to a number of conditions. In particular, point (b) requires that the purchased credit derivative be subject to the same or more conservative ‘material terms’ as those in the corresponding written credit derivative.

For the purposes of paragraph 3b, paragraph 4 of the same Article provides a number of additional conditions and clarifications. Point (a) specifically requires that “*the purchased protection is certain to deliver payment in all potential future states*”. We ask the PRA to provide a definition with examples of how to assess ‘certainty’.

MREL

(i) Deduction of MREL holdings

Along similar lines, where firms are required to deduct their holdings of other firms' MREL from their own MREL supply (i.e. the numerator in the MREL leverage ratio requirement), we assume they should similarly remove them from the Leverage Exposure Measure, as is the case for the Tier 1 in the Tier 1 leverage ratio requirement but would appreciate the PRA's confirmation that this is indeed its expectation.

There is an asymmetric treatment of deductions between MREL in the leverage ratio framework arising from the transposition of CRR, which we consider to be an error in drafting and out of line with the principle of removing deducted items from the LEM; this is an opportunity for the PRA to correct that in the UK leverage ratio framework.

More generally, we would encourage a more coherent approach to the leverage-aligned measure for MREL, particularly where a firm is not required to meet the leverage ratio as part of the capital-based requirements but is required to meet a leverage ratio requirement for MREL. Many UK banking entities are not subject to the leverage ratio but find their binding constraint is the MREL leverage ratio measure. This lacks coherence in cases where the leverage ratio is not considered necessary for their capital-based prudential requirements.

It may be that some investors do not fully understand the implication of this supervisory expectation on MREL requirements - so we would very much welcome an explicit statement to this effect in section 5 of the revised SS45/15, perhaps along the lines of:

"*There will be no impact on MREL requirements arising from the supervisory expectation that firms should normally maintain a leverage ratio of at least 3.25%*"

In addition, without a leverage ratio for the capital-based requirement, the current approach to deduction of buffers from MREL resources yields an odd result: under PRA Supervisory Statement 16/16 *The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions,* firms with no leverage ratio requirement must deduct the RWA-based capital buffers in full. But some of these firms still have leverage-based MREL as their binding constraint, thus being subject to the 'worst of both worlds', rather than their 'effective buffer' – which is the stated aim of the requirements.

We propose that firms which are not required to comply with a leverage ratio, not be required for MREL purposes to meet the MREL leverage ratio requirement, but instead just comply with the risk based MREL ratio.

(ii) Calculation of MREL requirements

Holdings in internal MREL are deducted from a firm's MREL resources, however they continue to be included in the measure to calculate the minimum requirement under both RWA and leverage ratio resulting in double counts. This point was included in responses to the Bank of England's consultation on its Statement of Policy on Internal MREL[3] in 2018, acknowledged in paragraph 3.10 of the feedback to the industry, and in the more recent Discussion Paper[4] on its approach to setting a minimum requirement for own funds and eligible liabilities in December 2020.

Para 3.10 states:

"Some respondents also asked whether investments in internal MREL will be deducted from RWAs and leverage exposures, in line with the FSB's Principles. The Bank notes that this treatment already applies to own funds instruments, where there are deductions for investments in own funds instruments of subsidiaries. The RWA and leverage treatment of investments in internal MREL eligible liabilities may be affected by the outcome of EU negotiations to update the EU prudential and resolution frameworks and the Bank will continue to engage with the PRA on this issue."

We note that at the international level, as evidenced by the Financial Stability Board guidance in its international standards on internal TLAC, allows for investments in internal TLAC subject to deduction to be deducted from the RWAs and leverage exposures.

It is recommended that for the purposes of calculating the MREL requirement, internal MREL investments in own funds and eligible liabilities which are deducted should be excluded from the leverage exposure measure and risk weighted exposure amount in line with international approach set by the FSB and thereby creating a level playing field.

Cash pooling arrangements

When calculating the exposure value of assets, paragraph 2 of article 429b in the leverage ratio (Part Seven CRR) part of the proposed rulebook, the netting of transactions in a cash pooling arrangement is permitted where the credit and debit balances of several individual accounts within the arrangement are transferred into a separate single account, with the balance of the original accounts set to zero on a daily basis.

Where the transfer or sweeping of balances to a separate single account does not occur on a daily basis, netting may still be permitted provided the arrangement meets a number of conditions as laid out in paragraph 3 of article 429b.

One of these conditions is that "*the frequency by which the balances of all original accounts are transferred is adequate for the purpose of including only the combined balance of the cash pooling arrangement in the total exposure measure*".

This text is identical to that which has been included in the EU CRR II, save for their requirement that the competent authority must consider the frequency to be adequate.

[EU CRR II: "*the competent authority of the institution considers that the frequency by which the balances of all original accounts are transferred is adequate for the purpose of including only the combined balance of the cash pooling arrangement in the total exposure measure*".]

[3] https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/policy-statement-boes-approach-to-setting-mrel-2018.pdf?la=en&hash=5DE6B6F258D5E9835F9CA6261A9050BFC666D8C4

[4] https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/boes-review-of-its-approach-to-setting-mrel.pdf?la=en&hash=E91E4A0380DE04A1EA5F1AB678EE8006041A344D

Now that the PRA has removed this extra level of governance, we ask the PRA to indicate what is meant by ‘adequate’ and clarify the minimum frequency that would be considered to meet this definition.

In particular, we ask the PRA to consider the examples below of pooling arrangements where transfers are not performed daily and ask it to confirm that the frequency of transfers in each of the following examples would be deemed ‘adequate’ in accordance with the Article 429b(3)(d).

Example 1: Maximum Sweep

Balances are transferred from the individual ‘child’ accounts to the master account only if the balance in the child account is greater than a predetermined threshold. The frequency on this type of arrangement can be any number of days as agreed with the client but is most commonly 1-4 days.

Example 2: Minimum Sweep

Balances are transferred from the individual child accounts to the master account in the event that the balance in the master account falls below a predetermined threshold. There is no set frequency applied to this type of arrangement and transfers occur as required and determined by the threshold.

Example 3: Zero Balancing & Reverse Sweep

All balances in the individual child accounts are set to zero and transferred to the master account either at the end of the day or at a specific time during the day (intraday transfer). However, balances are returned to the child accounts the next morning or for intraday transfers later during the same working day, in a reverse sweep. Particularly, we would like confirmation that a transfer frequency of 12 months would be acceptable, with the ability to undertake reverse transfers on the same or next business day.

Alternatively, if PRA advises that firms could assess the adequacy themselves based on their own internal mechanism, we ask it to provide guidance on any regulatory requirements or expectations on such mechanism.

Reporting issues

(i) Solo level reporting

As the current CRR Leverage requirements are expected to fall away once the UK leverage framework changes become effective at the beginning of January 2022, the status of the Solo leverage reporting requirement is not clear for the year 2022 as the Solo or sub-consolidated UK leverage ratio reporting requirement (based on PRA approval) will only be effective from beginning of January 2023. We would ask that the PRA clarifies UK leverage ratio reporting requirements for the year 2022, and whether these remain at the current levels of application for the existing in-scope banks and across all relevant reporting and disclosure items.

Furthermore, we request the PRA to clarify the Solo leverage reporting requirements in respect of entities which will be granted an approval for sub-consolidation effective at the beginning of January 2023; we are concerned that the existence of Solo reporting in conjunction with sub-consolidated reporting will not only create additional reporting burden for firms, but also form a shadow Solo leverage regime with additional regulatory constraints that are not transparent. We therefore urge the PRA to switch off Solo leverage reporting requirements for all sub-consolidated entities and in all reporting items, including Capital plus, in cases where a sub- consolidation approval is granted.

For the entities who will be granted approval for sub-group reporting instead of Solo from the beginning of January 2023, the MREL and Tier 1 Leverage requirements will diverge, as MREL requirements are entity based. We suggest alignment of level of application for both requirements.

Paragraph 1.35 of the PRA consultation states: “the changes to scope and level of application of the minimum requirement, buffers, and related additional reporting and disclosure requirements for firms that would be newly brought into scope of the leverage ratio minimum requirement would become effective on Sunday 1 January 2023”.

It is not clear if the “additional reporting and disclosure requirement” refers only to the additional elements of reporting and disclosures as defined respectively in 1.2 of the “Reporting CRR” part and “Disclosure CRR” part, in which case would imply the standard reporting and disclosures would apply from 1 January 2022, or if it refers also to the standard reporting and disclosures requirements indicating that for those newly brought into scope entities all reporting will start from 1 January 2023.

(ii) Reporting of overseas assets

The UK leverage ratio requirement includes an additional threshold in Para 9.2:

> *all firms with retail deposits equal to or greater than £50 billion, or non-UK assets equal to or greater than £10 billion, when calculated on an individual basis, unless they are CRR consolidation entities referred to in (ii) or a ring-fenced body identified in (iii) that is the ultimate parent within an RFB sub-group*;

Para 9.3 further specifies that:

> *For this purpose, non-UK assets means financial assets for which the counterparty is resident in a country or territory outside the UK. Most firms currently report this information in Financial Reporting (FINREP) Template F20.4*

Para 9.12 proposes that:

> *the definition of non-UK assets be aligned with that used for reporting template F20.4 (geographical breakdown by residence of the counterparty). Firms would calculate their non-UK assets from F20.4 by subtracting those assets where the counterparty is resident in the UK from their total assets reported in this form*

Para 9.13 states:

> *Certain firms with total assets greater than £5 billion already report a geographical breakdown of assets by residence of the counterparty in Template F20.4, but others do not. To ensure that all firms provide this information, the PRA proposes to require all firms with total assets greater than £5 billion to report their non-UK assets in the leverage ratio template LV44, row 0050 (see Chapter 14). The PRA considers that the £5 billion reporting threshold is proportionate to capture firms that may be within the proposed scope of the leverage ratio, without being unduly burdensome to those that are unlikely to be. For all firms reporting in template F20.4, the PRA would expect the total non-UK assets reported in LV44, row 0050, to be consistent with the information provided in F20.4.*

This raises the following questions/comments:

1) Is the reference to £5 billion in para 9.13 an error? Should this be £10bn?

2) If the reference to £5 billion in para 9.13 is correct, then it seems disproportionate to expect banks with total assets less than £10bn but greater than £5bn to report their non-UK assets in leverage template LV44 as it would not be logically possible for them to exceed the £10bn threshold noted in para 9.2.

3) Are banks that do not currently report F20 templates now expected to complete them? Para 9.13 is ambiguous.

4) Does it mean that entities not subject to leverage ratio minimum requirement are subject to the COREP reporting?

Need for a level playing field

We believe there are a number of instances where the proposals in this CP would be super-equivalent to other jurisdictions, which could create an unlevel playing field. The FPC paragraph 2.7 states "The FPC considers that the existing leverage ratio framework delivers a level of resilience at least as great as that required by international standards." We note this is being achieved both through the additional leverage requirement for a CCyB and not adopting various exemptions adopted in Europe. We believe that the combination of these factors has a disproportionate effect on UK banks. The key issues of concern are:

(i) Export Credit Agency (ECA) guarantees

Under EU rules, guaranteed parts of exposures arising from export credits can be deducted from LEM. Guarantees from ECAs are important mechanisms for allowing countries to help their exporters by supporting commercial contracts. They enable other countries (mainly developing countries) to purchase goods and services from the exporter's home country. Not allowing this deduction in LEM would have an adverse impact both on global trade flows and also on developing economies' access to vital goods and capital investment. It would also put UK banks at a disadvantage to EU banks. We hence suggest the PRA should allow the guaranteed parts of exposures arising from export credits to be deducted from LEM.

(ii) Use of CET 1

As we understand it at least 75% of the 3.25% leverage ratio in the UK must comprise CET1. However, this requirement is not consistent with other jurisdictions, and the Basel standard. This could have unintended consequences, for example, some UK firms may have to issue equity purely in order to be able to meet this requirement with adverse implications for Return on Equity and potential shareholder dilution.

The 7% minimum CET1 conversion ratio is also much higher than other competitors, with the average requirement being around 5.2%.

(iii) Buffers

The ALRB being set at 35% of the G-SIB / O-SII requirement is beneficial compared to the 50% outlined in the Basel reforms / EU requirements, but we believe the CCLB significantly penalises UK firms, in particular those with UK-focussed business, as such a buffer is not applied to leverage in other jurisdictions. The CCLB buffer for UK-focussed firms will be around 0.7% in the 'Standard Risk Environment' (as the UK Countercyclical Capital Buffer will be 2%) which will make the overall Leverage-based capital requirements in the UK at that point super-equivalent compared to international jurisdictions.

While UK Finance fully supports ensuring financial resilience, it is important for the future competitiveness and attractiveness of the UK that firms operating in the UK (both domestic and international) are not placed at a disadvantage from having significantly higher capital requirements under the Leverage Ratio than non-UK firms have under their local rules. We therefore ask the FPC and PRA to align with the international Leverage Ratio standard and discontinue the application of the CCLB buffer for leverage ratio purposes.

Further clarity requested

Please find below a number of points for which it would be helpful to have further clarity on:

(i) Paragraph 11.6(iii): Includes the following: "The PRA considers this approach would be prudent, given qualifying accounts are deemed economically equivalent to a single account, and proposes to implement it in respect of Tier 1 capital that is eligible for the UK leverage ratio's capital measure." It is not clear to us what the reference to Tier 1 capital is, as cash pooling relates to the LEM.

(ii) Appendix 2 (1.A.2.i), in the footnote, the reference to LV40 seems incorrect; it should be LV44.

(iii) Template LV47, Row 0130 description "Exempted CCP leg of client-cleared trade exposures (original exposure method)" is incorrect, it seems a copy paste from Row 0120. It should be "Capped notional amount of written credit derivatives".

(iv) Template LV47, Row 0490 states to report based paragraph 1 of Article 468 of the CRR. Article 468 transitional expired at the end of 2017 and so the relevance of Row 0490 is unclear.

(v) Template LV40, the excel template circulated as appendix 6a includes column 0040, Add-on for SFTs, which has all cells greyed out. Please confirm this column is not for input and will be deleted.

(vi) Template LV40, please confirm that row 0090 should exclude central bank exposures and that central bank exposures are then reported separately in row 0380.

(vii) Template UK LR1 – LRSum, it is not clear where certain deductions from / adjustments to capital should be reflected in the return. These include items such as intangible assets, thresholds deductions, pension etc.

Row 11 has a title of "(Adjustment for prudent valuation adjustments and specific and general provisions which have reduced tier 1 capital (leverage))" and references points (a) and (b) of Article 429a(1).

429a(1)(b) “any items, other than liabilities, deducted in the calculation of the capital measure referred to in Article 429(3);” would seem to include these types of deduction / adjustment, although this is unclear from the row title.

(viii) We suggest that all definitions are replicated in the glossary for ease of reference. At present, every part of the rulebook has its own dictionary with only a few in the glossary.

(ix) SS45-15, part 4, 4.1 which sets out conditions for forming a sub-consolidation group contain two (i)’s. Numbering needs to be corrected.

(x) Typo in Glossary part in the definition of tier 1 capital (leverage). There are two (b)’s.

(xi) Error in the Disclosure part. The definitions of the 'average exposure measure' and 'average leverage ratio' refer to Article 451(5)(a) and 451(5)(b). These do not exist as the entirety of paragraph 5 relates to the period after 1 January 2023. Remove reference to (a) and (b).

(xii) Clarification is also required on the scope of the COREP reporting requirement. The issue is whether it is only aligned to the binding leverage ratio requirement or, alternatively whether firms that do not need to comply with the leverage ratio requirement nonetheless also subject to the COREP reporting requirements.

(xiii) For the purpose of calculating an averaged leverage ratio over a reporting quarter, PRA mentioned the capital measure and relevant deductions and adjustments should be calculated based on end-of-month averages [ref: app2 3.2]. May PRA specify what these relevant deductions and adjustment include?

(xiv) The LV41(LR2) template requests the breakdown of all on- and off-balance sheet exposures in accordance with the risk weights applied under the credit risk section of the CRR. Hence, we believe the exemptions and deductions specific to leverage such as cash pooling, central bank claims, regular way, securitisation etc. need not be considered but only the exposures deducted from the regulatory capital. May PRA confirm if this is the correct understanding?

(xv) Template LV 47.00 – Reporting of replacement cost (rows 0061-0071)

For single netting sets that are subject to margin agreements, the calculation of RC will be the higher of i) CMV – VM – NICA; or ii) TH + MTA – NICA.

In the case of derivative contracts with clients where those contracts are cleared by a qualifying central counterparty, how should these components be presented in template LV 47.00 (LR Calc) in the event VM or NICA being “net posted”?

With respect to the following example, we ask the PRA to confirm the correct approach to presenting RC components in general and to specifically address reporting issues which arise when VM or NICA is ‘net positive’ and provide an explanation of the correct presentation in the proposed template. Alternatively, the PRA may choose to review the validation rules and consider introducing new rows in the template for net posted amounts of VM and NICA which are to be reported with a positive sign.

	Example
Trade 1- Exposure	500
Trade 2- Exposure	-400
Cash VM Posted	100
Cash VM Received	50
Other Collateral Posted	80
Other Collateral Received	70

CMV = 500-400 = 100

VM = 50 – 100= -50[being net cash VM posted in accordance with CRR Art 429c(3) and EBA Q&A 2020_5617].

NICA = 70-80 = -10

RC = CMV – VM – NICA = 100 + 50 + 10 = 160

Row	Exposure Value	RC Component	Problem	Possible Solution
0061	Derivatives: replacement cost under the SA-CCR (without the effect of collateral on net independent collateral amount (NICA))	CMV or TH + MTA	100	=100+10
0065	(-) Effect of the recognition of collateral on NICA on QCCP client-cleared transactions (SA-CCR - replacement cost)	(-) NICA	10 Invalid Signage	0
0071	(-) Effect of the eligible cash variation margin received offset against derivatives market value (SA-CCR - replacement cost)	(-) Cash VM received	-50	50

(xvi) Template LV 47.00 – Reporting of initial margin (row 0220)

We ask the PRA to confirm whether the "(-) Exempted CCP leg of client-cleared trade exposures (initial margin)" in row 0220 of LV 47.00 should be reported on a gross basis, or post-volatility adjustments.

UK Finance and its members welcomed the recent round table with the Bank of England on possible changes to the UK leverage ratio framework and look forward to discussing with the PRA the observations and suggestions made in this response to this CP when appropriate.

Responsible Executive

✉ robert.driver@ukfinance.org.uk
☎ +44 (0) 7590 711199