



June 13, 2014

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Robert de V. Frierson, Secretary

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary

**Re: Comment Letter on the Proposed Rule to Modify the Denominator of the US Supplementary Leverage Ratio and the Enhanced Supplementary Leverage Ratio
(Docket ID OCC-2014-0008; Docket No. R-1487 RIN AE-16; RIN 3064-AE12)**

Ladies and Gentlemen:

The Bankers Association for Finance and Trade (BAFT) is an international financial services trade association whose membership includes a broad range of financial institutions throughout the global community. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT member banks provide leadership to build consensus in preserving the safe and efficient conduct of the financial system.

BAFT appreciates the opportunity to comment on the proposed leverage ratio denominator rule issued by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board ("the Agencies") entitled *Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio* ("US Proposal").¹ Our comments are limited to Question 14 of the proposal on the use of the Standardized Approach Credit Conversion Factors (CCF) for off-balance sheet exposures (OBS).² We applaud the agencies' proposed adoption of the methodology of the Basel Committee on Banking Supervision ("Basel Committee" or "the Committee") for calculating off-balance sheet instruments in the Exposure Measure and firmly believe that the proposal in this regard should be swiftly adopted for the US Supplementary Leverage ratio and the Enhanced Supplementary Leverage Ratio.³

¹ Regulatory Capital Rules: *Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio*; April 8, 2014 ("US Proposal")

² IBID, Question 14: *What are commenters' views on the proposed CCFs for off balance sheet items? What, if any, modifications should be made to the proposed CCFs for any specific off balance sheet items?*

³ Instead of using a uniform 100% CCF, which converts an off-balance sheet exposure to an on-balance sheet equivalent, the leverage ratio will use the same CCFs that are used in the Basel framework's Standardized Approach for credit risk under the risk-based requirements, subject to a floor of 10%: Basel Committee on Banking Supervision; *Basel III leverage ratio framework and disclosure requirements*, Para 38-39; January 2014 ("Basel III Leverage Ratio") and *US Proposal*; 79 Fed. Reg 24,598

Bankers Association for Finance and Trade

1120 Connecticut Avenue NW, Washington, DC 20036 USA Telephone +1.202.663.7575 Fax +1.202.663.5538
www.BAFT.org - Info@baft.org

Key Recommendations:

1. Adopt Standardized Approach CCFs for Off-Balance Sheet Products in the Exposure Measure Calculation

BAFT supports the goals of the US Proposal in promoting a more resilient banking sector and we agree that a strong banking system and robust bank capital standards are the foundation for sustainable economic growth. We also support efforts to impose a leverage ratio as a means to reinforce and complement the risk-based capital requirements with a simple 'backstop' measure. We strongly believe the Agencies should continue to closely consider the overall effects of the Exposure Measure and the calibration of the leverage ratio to ensure it remains the backstop under the final rules.

As we stated in our comments to the Agencies in October 2013, (i) the Supplementary Leverage Ratio could become the binding minimum capital requirement for a significant number of US global systemically important banks (GSIB) and their subsidiary insured depository institutions (IDI) and (ii) the Exposure Measure would benefit from being adjusted to mitigate the impact on the pricing and availability of traditional trade finance instruments in this regard.⁴ As such, we specifically noted that the application of a 100% CCF for trade finance off-balance sheet exposures in the denominator calculation would be inappropriate and detrimental to the provision of international trade. Through our comments, we recommended use of the Basel Standardized Approach credit conversion factors of 20% for trade related contingencies and 50% for transaction related guarantees rather than a flat 100% CCF.⁵ These values reflect both the low-risk nature of trade finance and the fact that the overwhelming majority of OBS trade exposures do not convert to on-balance sheet exposures.

We were encouraged that the Basel Committee in January 2014 determined that the most appropriate measure of exposure for off-balance sheet items generally would be their credit equivalent value. The Committee noted that the application of the credit equivalent value in the context of unfunded trade finance transactions and other OBS items reflects the fact that the degree of leverage in these transactions is not the same as if banks had made fully funded loans and that a 100% CCF overestimated leverage. As stated by the Chairman of the Basel Committee, "the use of standardized CCFs retains a consistent and conservative treatment that is not dependent on the risk of the bank's counterparty."⁶ Standardized Approach CCFs are not risk-weights but are instead tools to estimate actual exposure amounts. They are also reasonable proxies for Exposure Measures because they estimate the drawn amount of a commitment and they are much better measures of actual exposure than the 100% CCF set forth in the original proposal.

We believe the proposal by the Agencies to adopt the Basel Committee method of calculation for off-balance sheet CCFs is the right approach. In particular, for trade finance, this will assist in avoiding the diversion of capital to other financial instruments or the reduction in the provision of OBS trade/transaction lending. This will also mitigate any disproportionate increase in the cost of providing these products to customers (importers and exporters). This revised Exposure Measure calculation should be adopted for banks subject to both the Supplementary Leverage Ratio and the Enhanced Supplementary Leverage Ratio.⁷

⁴ BAFT-IFSA Comments on *Notice of Proposed Rulemaking: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions*; October 21, 2013

⁵ Basel Committee on Banking Supervision; *International Convergence of Capital Measure and Capital Standards: A Revised, Comprehensive Version*, June 9, 2006; Para 82-86

⁶ *Banking on Leverage*; Stefan Ingves, Chairman, Basel Committee on Banking Supervision and Governor, Sveriges Riksbank; Keynote address to the 10th Asia-Pacific High-Level Meeting on Banking Supervision. February 2014

⁷ The Enhanced Supplementary Leverage Ratio will apply to US top-tier bank holding companies with more than \$700 billion in consolidated total assets or more than \$10 trillion in assets under custody (covered Bank Holding Companies or "BHC") and their IDI subsidiaries. Covered BHCs must maintain a leverage buffer greater than 2 percentage points above the minimum supplementary leverage ratio requirement of 3%, for a total of more than 5%, to avoid restrictions on capital distributions and discretionary bonus payments. IDI subsidiaries of covered BHCs must maintain at least a 6% supplementary leverage ratio to be considered "well capitalized" under the agencies' prompt corrective action framework. The 3% Supplementary Leverage Ratio will apply to all other Advanced Approaches US banking organizations.

2. Revise CCFs for Non-financial Guarantees and Standby Guarantees Related to International Trade

BAFT believes the Agencies should consider adjusting the CCF for non-financial guarantees and standby guarantees related to international trade from 50% to 20%.⁸ Non-financial guarantees and standby guarantees connected to global commerce are essential products supporting cross-border movement of goods and services and their historical performance data substantiates a 20% CCF calculation. The International Chamber of Commerce (ICC) analyzed the default rate for performance guarantees, alongside performance standby letters of credit. Their low default rates and low rates of conversion on balance sheet enumerate the fact that these types of trade finance products are low-risk, particularly when compared with corporate loans.⁹

Through Capital Requirements Directive IV (CRDIV/CRR), the European Union (EU) adjusted the CCF for non-financial guarantees and standby guarantees to 20% for the purposes of the Basel III leverage ratio calculation.¹⁰ By taking this step, the EU recognized the intrinsic nature of these products and their low-risk profile. This treatment should be considered by the Agencies in their implementation of the revised leverage ratio Exposure Measure and should be harmonized across all jurisdictions of the Basel Committee through further multilateral review of the Standardized Approach CCFs in this regard.

Conclusion:

BAFT thanks the Agencies and the Basel Committee for the important revisions to the leverage ratio treatment of OBS products. We believe that the appropriate regulatory treatment for the financing of international trade and real economy banking products will ultimately have a positive effect on global markets and will spur job creation and growth. We very much appreciate the opportunity to comment on the US Proposal and look forward to further dialogue with the Agencies and with the Basel Committee on these issues going forward.

Very truly yours,



Tod R. Burwell
President and Chief Executive Officer

⁸ Non-financial guarantees and standby guarantees include warranties (including tender and performance bonds and associated advance payment and retention guarantees) and guarantees not having the character of credit substitutes, along with irrevocable standby letters of credit not having the character of credit substitutes.

⁹In particular, for a dataset of 609,920 transactions from 2008 to 2011, performance guarantees had an average default rate of 0.034%, representing only 208 transactions. The ICC also provides two measures of the extent to which products do or do not convert on balance sheet: (i) the number of document sets rejected on first presentation; and (ii) the number of transactions that expire without payment. Expiries are highly common on guarantee products, especially for performance guarantees where approximately 85% expire without bank payment (i.e. a claim is only made on around 10% of guarantees). This is understandable as this kind of product is used to protect against the unexpected lack of performance of the counterparty. International Chamber of Commerce, *Global Risks Trade Finance Report 2013*, p.15 and p.22

¹⁰ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRDIV/CRR): Article 429, Para 10 (b) and (c) and Annex 1