BAFT-IFSA

October 21, 2013

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Robert de V. Frierson, Secretary
Docket No. R-1460
RIN 7100-AD99

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
Docket ID OCC-2013-0008
RIN 1557-AD69

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE01

Re: Notice of Proposed Rulemaking: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions

Ladies and Gentlemen:

BAFT-IFSA 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-IFSA member banks provide leadership to build consensus in preserving the safe and efficient conduct of the financial system.

BAFT-IFSA appreciates the opportunity to comment on the proposed leverage ratio 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, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions* ("U.S. Proposal").[1] We are concerned; however, that the US proposal could have an adverse effect on the availability and affordability of trade finance and could result in reduced global trade flows at a time when they are essential to support economic recovery.

Introduction and Overview:

BAFT-IFSA supports the goals of the US Proposal in promoting a more resilient banking sector and we agree that a strong banking system and strong bank capital 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 have very serious concerns,

[1] Regulatory Capital Rules: *Regulatory Capital Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions*, 78 Fed. Reg. 51,101; August 20, 2013

however, about the timing and substance of the US Proposal, and the unintended consequences for international trade that will arise if the proposal is finalized in its current form.[2]

In June 2013, the Basel Committee on Banking Supervision ("Basel Committee" or "the Committee") issued a consultative document ("International Proposal") that would alter and greatly expand the exposures that are captured in the supplementary leverage ratio's denominator.[3] Before the Agencies move forward with raising the supplementary leverage ratio's level, it is imperative for the Agencies to clearly indicate the exposures that will be captured under the future framework. Accordingly, BAFT-IFSA believes that the Agencies should postpone consideration of the US Proposal until the Basel Committee has provided a detailed recommendation on the Exposure Measure and a comprehensive study is undertaken as to the impact of bank capital and other financial reform regulations on the ability of financial institutions to provide financial services, including trade finance and export finance, to consumers and businesses.

In parallel, the Agencies should work through the Basel Committee process to ensure capital standards, including leverage ratios, are comparable internationally and address unintended consequences emanating from the standards in a uniform and harmonized manner. As such, the Agencies should reaffirm the principle that the leverage ratio is intended to be supplementary and a backstop and will not become the binding capital ratio that supersedes the risk-based requirement. The Agencies and the Basel Committee should further work to address issues in the Exposure Measure which could detrimentally impact global trade.

Key Recommendations:

1. Ensure the leverage ratio remains a supplementary requirement

BAFT-IFSA believes that the US proposal, in its current form, would reverse the intended relationship between the two types of capital requirements for a substantial number of US institutions, with the leverage ratio becoming the binding requirement and the risk-based requirements becoming the supplemental backstop. As banks manage to each individual capital constraint for each financial product, a leverage ratio set at 5 percent for the Bank Holding Company (BHC) and 6 percent for the Insured Depository Institution (IDI) will begin to supersede the capital requirements mandated under the Basel Advanced Approaches and the Basel Standardized Approach. Such a reversal would very likely result in damaging consequences for the real economy

A binding leverage ratio would cause banks to increase pricing for certain products or reduce product offerings. Banks would also be encouraged to hold assets that are more, rather than less, risky. With a "one-size-fits-all" requirement, riskier assets will produce a higher relative return on capital than safer assets. This will ultimately have a direct impact on the provision of trade finance - a short-term, low risk financing product - to companies around the world. This outcome is fundamentally at odds with the sensible risk management and pro-growth economic policies espoused by the US Administration, the Basel Committee and the G-20.

A higher, binding, leverage ratio specific to the US will also cause disparity in the international implementation of Basel III and will lead to competitive disadvantages in the financing of international trade. By unilaterally increasing the US supplementary leverage ratio relative to other Basel Committee member states, the potential for regulatory arbitrage will lead to an uneven playing field for US

[2] In its current form, the US Proposal would require a supplemental leverage ratio surcharge of Tier 1 capital on eight US bank holding companies (Covered BHCs) identified as global systemically important banks (GSIBs) and their insured depository institutions (IDIs). The US Proposal would require a Covered BHC's IDI subsidiaries to maintain a Basel III supplementary leverage ratio of at least 6 percent to be considered well-capitalized under the prompt corrective action framework. In addition, Covered BHCs would be subject to a leverage ratio of 5 percent (3 percent minimum plus 2 percent buffer). This proposal is substantially higher than the 3 percent global leverage ratio proposed by the Basel Committee on Banking Supervision and agreed to by the leaders of the G-20 for uniform implementation.

[3] Basel Committee on Banking Supervision; *Revised Basel III leverage ratio framework and disclosure requirements*, June 2013

institutions, ultimately impacting the downstream financing of US companies wishing to increase jobs through exports. This is particularly pertinent as US global systemically important banks (GSIBs), to whom the US Proposal is addressed, finance a major portion of cross-border transactions for US companies.[4] By impeding this financing, the progress of the US National Export Initiative (NEI) and other efforts meant to grow the economy through international trade, could be significantly curtailed.[5]

As such, the Agencies should not unilaterally increase the leverage ratio to become the binding capital requirement for firms, thereby eliminating the fundamental rationale for, and benefits of, internationally harmonized risk-based capital requirements. The Agencies should postpone consideration of the US Proposal and work through the Basel Committee process to ensure a correct calibration and Exposure Measure of a global leverage ratio that will not create detrimental downstream economic effects.

2. Address Exposure Measure implications for trade finance

As noted, if the Agencies move forward with the US Proposal, it is likely that the supplementary leverage ratio will become the binding minimum capital requirement for a significant number of US GSIBs and their subsidiary IDIs. In addition, the leverage ratio Exposure Measure contemplated by the US Proposal, and particularly the greatly expanded Exposure Measure considered by the International Proposal, will specifically invoke detrimental consequences for trade finance. [6]

To help mitigate these consequences, it is important for the US Agencies to work within the context of the Basel Committee to distinguish the criticality of trade finance to global economic growth through a coordinated revision of the leverage ratio denominator. To that end, certain aspects of the calibration that were adopted in 2010 should be revisited and modified.

a. Adjust Credit Conversion Factors (CCF) for off-balance sheet trade finance instruments

The application of a 100 percent CCF for trade finance off-balance sheet (OBS) exposures in the denominator calculation of the leverage ratio would be inappropriate and detrimental to the provision of international trade.[7] Trade finance instruments, which are low-risk, short-term financing products with low drawdown rates, are critical to support global trade in goods and services. Where the leverage ratio becomes the binding constraint on a bank (or has potential to become a binding constraint) a 100 percent CCF for trade finance OBS instruments may encourage banks to divert capital to other financial instruments, cease to provide OBS trade/transaction lending or increase the cost of providing these products to customers (importers and exporters).

While we recognize the supplementary leverage ratio is designed to be simple, the use of a 100 percent CCF for trade finance is excessive given the objective the leverage ratio intends to achieve. The

[4] A survey of the US Business Roundtable's 211 member CEOs found that 89 percent use large US banks to facilitate overseas transactions. Nearly half of the responding CEOs reported that trade finance services provided by large US banks are essential and useful to their companies' operations. (Business Roundtable: *Business on Banking: How Large US Financial Institutions Help Companies Create Growth and Opportunity for America*; October 4, 2013: http://businessroundtable.org/uploads/studies-reports/downloads/20131004_Business_on_Banking.pdf)

[5] In January 2010, the US Administration set a goal of doubling exports by the end of 2014 by way of the NEI. The NEI is estimated to support two million additional jobs in the US and the Administration has, through this endeavor, committed to marshaling the full resources of the United States government behind American businesses that sell their goods and services abroad. Trade finance is a crucial component to growing exports and the US Leverage Ratio Proposal could have downstream implications for furthering the efforts of the NEI and the trade promotion agencies of the US government; Executive Order 13534 - National Export Initiative: http://www.whitehouse.gov/the-press-office/executive-order-national-export-initiative

[6] For further information on BAFT-IFSA's concerns with the International Proposal, please see: *BAFT-IFSA Letter to the Basel Committee on Banking Supervision, Revised Basel III leverage ratio framework and disclosure requirements*, September 20, 2013; www.baft-ifsa.com/policy/library-of-documents/leverage-ratio-comment-letter-2013

[7] Basel Committee on Banking Supervision; *Revised Basel III leverage ratio framework and disclosure requirements*, June 2013: Para 40-41 and Regulatory Capital Rules: *Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions*, 78 Fed. Reg. 51,101, 51,110; August 20, 2013

leverage ratio aims to constrain the build-up of leverage in the banking sector to avoid destabilizing deleveraging processes which can damage the broader financial system and the economy. Trade finance instruments are underpinned by the movement of goods and services; hence they do not lead to the kind of leveraging that may endanger real economic activity. [8]

In other areas of regulatory supervision recommended by the Basel Committee, trade finance has received recognition as an important, real-economy financing product. We note the statement in paragraph 66 of the March 2013 consultative document, *Supervisory Framework for Measuring and Controlling Large Exposures*, which reads:

> *".....the Committee considers it inappropriate to apply the flat 100 percent CCF to specific types of exposure if there is a risk that this could have material unintended consequences. This is the case for exposures linked to trade finance activities, where application of a flat 100 percent CCF is likely to have a material adverse impact on an essential form of financing in some countries, particularly in emerging markets."* [9]

As the Basel Committee is aware of the likely impact a flat 100 percent CCF could have on trade finance, the Committee and the US Agencies should extend consideration of this impact to the final calibration of the supplementary leverage ratio.[10] As such, we recommend use of the Basel II Standardized Approach credit conversion factors of 20 percent for trade related contingencies and 50 percent for transaction related guarantees rather than a flat 100 percent CCF.[11] These values reflect both the low-risk nature of trade finance and the fact that not all OBS trade exposures will necessarily convert to on-balance sheet exposures.[12]

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 blunt 100 percent CCF set forth in the proposed framework. It is noted that the Basel Committee and the US Agencies already agreed that OBS unconditionally cancelable commitments should receive a 10 percent CCF for the purposes of the leverage ratio, thus recognizing the intrinsic nature of those instruments in a

[8] Trade finance is also not a source of the kind of leverage that the Basel Committee was concerned about when creating the CCF framework. As stated in the Committee's formative paper on the ideas behind the CCF framework, the prime motivation for some off-balance sheet innovations has been the avoidance of capital requirements. The goal of the 100 percent CCF is to recapture those transactions that contribute significantly to a bank's leverage but are made opaque by the off-balance sheet treatment. Trade finance, in contrast, does not have the capital arbitrage motivation discussed in that report but instead is part of the "traditional" off-balance sheet commitments financing the real economy. (Basel Committee on Banking Supervision; *The Management of Banks' Off-Balance Sheet Exposures*, March 1986, p. 1)

[9] Basel Committee on Banking Supervision; *Supervisory Framework for Measuring and Controlling Large Exposures*, March 2013, p. 12, Para 66

[10] Additionally, in other parts of the Basel III framework, trade finance has been recognized for its unique nature. This includes the application of drawdown rates applied in the Liquidity Coverage Ratio (LCR). Trade finance instruments receive "a relatively low run-off rate (*e.g.*, 5 percent or less)," which appropriately reflects the low drawdown rates underpinned by the movement of goods or provision of services. These runoff rates conservatively assume a stressed environment in which "all facilities that are assumed to be drawn . . . will remain outstanding at the amounts assigned throughout the duration of the test, regardless of maturity." These conservative assumptions also should be appropriate as applied to OBS items in the leverage ratio context. (Basel Committee on Banking Supervision; *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools,* January 2013: p.33, Para 138)

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

[12] For discussion regarding the low rate of on-balance sheet conversion of trade finance products, please see: International Chamber of Commerce, *Global Risks Trade Finance Report* 2013; http://www.icctraderegister.com/docs/public/ICC%20Global%20Risks%202013%20Report%20Final%20Version.pdf: p. 22

way that will not harm the effectiveness of the ratio's overall purpose or its simplicity as a backstop measure. [13]

We also note that through Capital Requirement Directive IV (CRDIV/CRR), the European Union (EU) recognized the importance of the appropriate regulatory treatment of trade finance in their calibration of the leverage ratio.[14] The EU applied credit conversion factors of 20 percent for medium/low-risk trade finance products and 50 percent for medium-risk trade finance products rather than a flat 100 percent CCF. These sensible pro-growth and pro-trade changes to the leverage ratio should be adopted by the US Agencies and harmonized across all jurisdictions of the Basel Committee. In addition, and in line with CRDIV/CRR, the Committee and the US Agencies should recognize and mitigate the potential consequences for lending under officially supported export credit regimes, whereby OBS exposures related to these regimes would be converted to the Exposure Measure at full face value, thereby impeding global export flows.

b. Exclude cash and other high quality liquid assets (HQLA) from the Exposure Measure

BAFT-IFSA believes that cash and other high quality liquid assets (specifically Level 1 HQLA) should either be excluded from the Exposure Measure or discounted according to their relative levels of liquidity.[15]

The inclusion of cash in the Exposure Measure impacts a bank's trade finance business, as trade finance exposures are often cash collateralized. The cash placed as collateral with a bank will first be on the liability side of the balance sheet and, in itself, not be counted in the calculation of the leverage ratio. However, to have a squared balance sheet, this liability will be used to create an asset, most likely by passing the cash on to a Central Bank. As a result, the collateral on the one hand achieves a near risk-free trade finance exposure for the bank but on the other hand increases the Exposure Measure of the leverage ratio. This treatment penalizes banks for using cash collateral in their trade finance operations and has the potential to limit the ability of a bank to undertake certain trade financing transactions.

The leverage ratio Exposure Measure requirements also have implications for a banks' adherence to the Liquidity Coverage Ratio (LCR) requirements. The LCR requires banks to hold HQLA in case of a liquidity stress scenario. These assets (mostly held at Central Banks) are counted into the leverage ratio exposure although they cannot actually be used for anything other than HQLA and are not a source of leverage. Additionally, when a bank takes cash deposits from its clients, the cash is either matched off against a loan (*i.e.* used as funding) or it is placed with a Central Bank. If it is placed with a Central Bank, an asset is created on the bank's balance sheet which adversely impacts the leverage ratio Exposure Measure. By providing deposit taking services to its clients and passing the cash through to a Central Bank, banks are penalized for providing "basic" banking services due to the negative impact on the leverage ratio exposure. This creates a disincentive for providing client-based services like deposit taking.

By excluding cash and other Level 1 HQLA from the leverage ratio Exposure Measure, the US Proposal and the International Proposal will be better aligned to capture truly significant risk exposures and will eliminate or greatly reduce the perverse incentives to avoid cash and other high quality liquid assets.

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[13] Basel Committee on Banking Supervision*; Revised Basel III leverage ratio framework and disclosure requirements*, June 2013: Para 42 and Regulatory Capital Rules: *Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions*, 78 Fed. Reg. 51,101, 51,110; August 20, 2013

[14]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

[15] Level 1 HQLA as defined by the Basel Committee on Banking Supervision; *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools,* January 2013; p. 12, Para 50

Conclusion:

BAFT-IFSA believes that the appropriate regulatory treatment for the financing of international trade will ultimately have a positive effect on global markets and will spur job creation and growth in the real economy. 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

Tod R. Burwell
President and Chief Executive Officer