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From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL **on a possible extension of the leverage ratio buffer framework to O-SIIs and on the definition and calculation of the total exposure measure, including the treatment of central bank reserves.**

Delegations will find attached document COM(2021) 62 final.

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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on a possible extension of the leverage ratio buffer framework to O-SIIs and on the definition and calculation of the total exposure measure, including the treatment of central bank reserves.

Legal basis and scope of the report

Article 511 of Regulation (EU) No 575/2013 (Capital Requirements Regulation or CRR), as amended by Regulation (EU) 2019/876 (henceforth CRRII)[1], requires the Commission, by 31 December 2020, to submit a report to the European Parliament and to the Council on whether:

(a) it is appropriate to introduce a leverage ratio surcharge for other systemically important institutions (O-SIIs)[2,3]; and on whether
(b) the definition and calculation of the total exposure measure referred to in Article 429(4) of the CRR, including the treatment of central bank reserves, is appropriate.

The Commission is required to take into account international developments and internationally agreed standards in this report and to consider presenting a legislative proposal.

Leverage ratio surcharge for other systemically important institutions

The leverage ratio buffer requirement for G-SIIs has been introduced in EU law in accordance with an agreement of the Basel Committee on Banking Supervision (BCBS) of December 2017[4]. To date, a similar leverage ratio buffer requirement does not exist for the approximately 160 EU institutions that are currently identified as O-SIIs.[5]

The need to assess the appropriateness of introducing a leverage ratio buffer for O-SIIs stems from the fact that the CRRII introduced a leverage ratio buffer requirement for institutions identified as global systemically important institutions (G-SIIs). In the EU, there are currently eight G-SIIs. For these institutions, the buffer requirement is set at 50% of their risk-based G-SII buffer rate[6] and applies on top of the future leverage ratio minimum requirement[7] (Pillar 1 requirement) and the additional own funds requirement to address the risk of excessive leverage[8] (Pillar 2 requirement).

The CRRII envisaged the leverage ratio buffer for G-SIIs to be applicable as of 1 January 2022. However, Regulation (EU) 2020/873 postponed the date of application of the leverage ratio

[1] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1).
[2] O-SIIs are defined in Article 131 of Directive 2013/36/EU (Capital Requirements Directive or CRD), as amended by Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019, OJ L 176 27.6.2013, p. 338.
[3] Credit institutions are subject to a minimum leverage ratio requirement of 3% which will become applicable on 28 June 2021. The leverage ratio requirement aims to preserving financial stability by acting as a backstop to risk based capital requirements and by constraining the building up of excessive leverage during economic upturns, and complements the risk-based capital requirements.
[4] See Basel Committee on Banking Supervision (2017): Basel III: Finalising post-crisis reforms, p. 140-141.
[5] See https://eba.europa.eu/risk-analysis-and-data/other-systemically-important-institutions-o-siis-
[6] See Article 92(1a) of the CRR.
[7] See Articles 92(1), point (d), and 429a(7) of the CRR, as applicable.
[8] See Article 104(1), point (a), of the CRD.

buffer for G-SIIs by one year to 1 January 2023[9], to provide institutions additional capacity to respond immediately and effectively to the impact of COVID-19. This was in line with the revised implementation timeline agreed by the Group of Central Bank Governors and Heads of Supervision, the oversight body of the BCBS[10].

The CRR envisages two different dates for the Commission to consider the introduction of a leverage ratio buffer requirement for O-SIIs. Besides the above-mentioned report, which is due by the end of 2020, such a requirement for O-SIIs may be examined as part of the comprehensive 2022 review of the macroprudential toolbox in banking, as set out in Article 513 of the CRR[11]. That review is due by 30 June 2022. In view of the postponement of the application date of the leverage ratio buffer for G-SIIs, the Commission considers that the introduction of an additional buffer requirement for O-SIIs should rather be assessed as part of the Commission report required under Article 513 of the CRR. In this assessment, the Commission will have to take account of the fact that O-SIIs are a diverse group of institutions, with some being similar in size and activity to G-SIIs, while others are considerably smaller and more domestically focussed. This heterogeneity in the O-SII group warrants a careful assessment of the appropriateness of extending to this group the leverage ratio buffer requirement for G-SIIs.

Extending the leverage ratio buffer may indeed have broader repercussions that need to be considered in the context of other possible changes to the macroprudential framework for the banking sector that may be deemed necessary, notably in the light of lessons learned from the current crisis. It is therefore more appropriate to consider the extension of the leverage ratio buffer requirement to O-SIIs in the context of the comprehensive 2022 review of the macroprudential toolbox in banking.

Definition and calculation of the total exposure measure

The CRRII modified the calculation of the leverage ratio[12] to align the European framework with the revised international standard as included in the 2017 Basel III post-crisis regulatory reform package. These modifications were introduced inter alia to ensure an international level playing field for institutions established in the Union but operating also outside the Union[13].

Since the adoption of the CRRII, the BCBS has further revised one specific aspect of its leverage ratio framework. To facilitate the provision of client-clearing services, the **treatment of client-cleared derivatives** for leverage ratio purposes was amended in June 2019[14]. Under the revised

[9] See recital 17 and Article 2(2) of Regulation (EU) 2020/873, OJ L 204, 26.6.2020, p. 4–17.
[10] See BCBS press release "Governors and Heads of Supervision announce deferral of Basel III implementation to increase operational capacity of banks and supervisors to respond to Covid-19", 27 March 2020, available at: https://www.bis.org/press/p200327.htm
[11] See Article 513(1), point (e), of the CRR, which requires the Commission to assess whether the leverage ratio buffer requirement as referred to in Article 92(1a) of the CRR should be extended to systemically important institutions other than G-SIIs, whether its calibration should be different from the calibration for G-SIIs, and whether its calibration should depend on the level of systemic importance of the institution.
[12] See Article 1, point 117, of the CRRII.
[13] See recital 8 of the CRRII.
[14] See Basel Committee on Banking Supervision (2019): Leverage ratio treatment of client cleared derivatives, June 2019, available at: https://www.bis.org/bcbs/publ/d467.pdf

rules, the treatment of those derivatives is generally aligned with the treatment envisaged under the standardised approach for counterparty credit risk (SA-CCR) in the risk-based framework. The amendment permits institutions to offset the replacement cost and the potential future exposure for client-cleared derivatives by cash and non-cash forms of segregated initial margin and cash and non-cash variation margin received from a client.

Market participants have linked the former treatment of client-cleared derivatives to the increased concentration in the provision of clearing services[15]. Therefore, a revision is deemed essential, as it removes a disincentive for institutions to offer client-clearing services by lowering their variable cost without having a material impact on their overall resilience. The amendment should facilitate the provision of clearing services, which is in line with the objective of reforms enacted after the Global Financial Crisis to create incentives to centrally clear over-the-counter derivatives.

The revised BCBS provision on client clearing will become applicable as of 1 January 2023. In contrast to the BCBS treatment, under the revised European leverage ratio framework, which applies as of 28 June 2021, non-cash variation margin must still not be used to offset the replacement cost[16]. To provide European institutions with the same incentive to offer client-clearing services and to ensure an international level playing field, the CRR treatment of client-cleared derivatives should be aligned with the revised international standard. To ensure an alignment in a timely manner, the Commission intends to include the revision in the upcoming legislative proposal aimed at implementing the final elements of the Basel III reform.

As indicated at the beginning of this report, under Article 511 of the CRR, the Commission is also mandated to report on the appropriateness of the **treatment of central bank reserves** for leverage ratio purposes. Based on the revised 2017 Basel standard[17], the CRRII had introduced a discretion into the European leverage ratio framework to temporarily exclude certain central bank exposures from an institutions' total exposure measure in exceptional circumstances[18]. The purpose of that discretion is it to facilitate the effective transmission of monetary policy measures. Under the original offsetting mechanism set out in the CRRII, any impact of the exclusion of central bank reserves had to be fully neutralised by a strictly proportionate increase of an institutions' individual leverage ratio requirement.

The COVID-19 crisis has made it apparent that such an offsetting mechanism would have been too restrictive and that its application would not have facilitated an effective transmission of monetary policy. Indeed, since the exemption of central bank reserves would have been fully neutralised by an increase in the leverage ratio requirement, institutions would have been constrained with regard to the level of the increase of their central bank reserves. This, in turn, might have discouraged institutions from drawing on central bank liquidity facilities in a

[15] See BCBS, CPMI, FSB and IOSCO (2018): Incentives to centrally clear over-the-counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms, November 2018, available at: www.bis.org/publ/othp29.pdf
[16] See Article 429c(3) of the CRR.
[17] See Basel Committee on Banking Supervision (2017): Basel III: Finalising post-crisis reforms, p. 144.
[18] See Article 429a(1), point (n), and (5) to (7) of the CRR, as amended by the CRRII.

situation of stress to the extent needed, thereby hampering the effective transmission of monetary policy measures. Given their limited leeway to control the extent of central bank reserves during a crisis[19], institution could have been forced to deleverage by selling assets or reducing the level of lending to the real economy, or both.

In light of these findings, and based on a Commission proposal of 28 April 2020[20], the treatment of central bank reserves was revised by the co-legislators[21]. Under that revised treatment, the individual leverage ratio requirement of an institution that exercises the discretion will be adjusted only once, namely at the moment it exercises the discretion. The adjustment will be based on an average value of the institution's eligible central bank reserves and its total exposure measure on the date on which the exceptional circumstances are deemed to have started. The adjusted leverage ratio will apply throughout the full period during which the discretion is exercised and will not change like under the former offsetting mechanism.

The above revision, which will also become applicable on 28 June 2021, as envisaged under the original CRRII timeline, should enhance the effectiveness of the discretion and should provide the competent authorities with more flexibility to act appropriately and purposefully during possible future shocks and crises. Besides, in order to ensure the availability of that discretion during the current COVID-19 pandemic and until the revised treatment becomes applicable, a transitional discretion to temporarily exclude certain central banks reserves was introduced into the European leverage ratio framework[22].

Conclusion

The Commission does not consider it appropriate to introduce a leverage ratio surcharge for other systemically important institutions (O-SIIs) in the current context. This question should be examined as part of the comprehensive review of the macroprudential toolbox in banking by 30 June 2022, as set out in Article 513 of the CRR.

The Commission considers it appropriate to adjust the calculation of the total exposure measure referred to in Article 429(4) of the CRR to align the treatment of client-cleared derivatives with internationally agreed standards.

The legislator has already revised the treatment of central bank reserves via Regulation (EU) 2020/873. In the absence of further international developments on the treatment of central bank

[19] On that aspect, the European Central Bank noted that "*(...) an increase in central bank liquidity resulting from the conduct of monetary policy will lead to an increase in the quantity of reserves held by the banking system, as is the case for the recently announced monetary policy measures in relation to the COVID-19 crisis. While individual credit institutions are able to shift these reserves around, the banking system will not be able to avoid holding these additional reserves and the accompanying increase in the leverage ratio total exposure measure.",* Opinion of the European Central Bank of 20 May 2020 on amendments to the Union prudential framework in response to the COVID-19 pandemic (CON/2020/16) 2020/C 180/04, OJ C 180, 29.5.2020, p. 4-9.

[20] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic, 28 April 2020, COM/2020/310 final, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020PC0310

[21] See recital 9 and Article 1, point 4, of Regulation (EU) 2020/873.

[22] See Article 500b of the CRR.

reserves and in light of that recent revision, the Commission does not consider that additional amendments are necessary.