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From:	Presidency
To:	Delegations
Subject:	'Leverage Ratio' * Articles 92(1) (d), 429, 429a-429g CRR *

Delegations will find attached Presidency non-paper for the 15/16 February 2017 meeting.

Articles 92(1) (d), 429, 429a-429g CRR 'Leverage Ratio'

Background

Currently the CRR requires the calculation, reporting and disclosure of the leverage ratio (LR) in line with Basel III. The Commission's proposal took into account the latest revisions to the Basel III standard on the leverage ratio and introduced a binding (Pillar 1) 3% leverage ratio requirement. The proposal also introduced certain adjustments to the design of the leverage ratio, specifically:

- public development banks may reduce their leverage ratio exposure measure by the amount of public lending they provide[1] and institutions may reduce their leverage ratio exposure measure by the amount of loans originated by public development banks that they pass-through[2];
- institutions may reduce their leverage ratio exposure by the guaranteed part of officially guaranteed export credits;
- institutions may reduce the leverage ratio exposure measure by the initial margin received from clients for derivatives cleared through qualified central counterparties (QCCPs)[3].

It is worth noting that the Basel Committee is currently considering the introduction of additional requirements for globally systemically important banks (G-SIBs). In this regard, Recital 13 of the Commission proposal refers to the possibility of having future amendments to the CRR in order to cater for the appropriate calibration of the Leverage Ratio for systemically important EU institutions.

Feedback provided by Member States

Member States support the 3% level as a minimum requirement for the leverage ratio.

Based on the comments provided in the questionnaires and during the meeting held on 24 January 2017, there are a significant number of Member States that not only support the proposed calibration but also agree on including a higher leverage ratio requirement for G-SIIs. However, the majority of Member States who agree on including higher requirements for G-SIBs would prefer to wait for the outcome of Basel discussions.

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[1] The intention behind this adjustment is to prevent a negative impact on the public lending activities of those institutions. Since public development banks are not internationally active they do not fall within the scope of the Basel framework. The adjustment therefore cannot be considered as a deviation from the internationally agreed standards.

[2] The intention behind the adjustment is to exclude pass-through loans which usually do not represent an exposure for the institutions that pass them through to the final borrowers as they do not bear any risk in case those loans are not repaid (i.e. the risk stays with the originator of the loan).

[3] The intention behind this adjustment is to prevent a negative impact on the clearing obligation and on the broader objective of the CMU.

In addition, some Member States would also consider the introduction of a higher leverage ratio requirement for other systematically important institutions (O-SIIs), whereas others oppose including such additional requirements.

With respect to the exclusions from the exposure measure, Member States have mixed views. Some Member States are not supportive of the additional amendments and suggest that the proposal should not deviate/limit deviations from Basel text. Others require amendments to the exclusions as proposed by the Commission.

Some Member States also expressed concern that CCPs holding a banking licence were not exempted from an LR requirement as recommended in the EBA Report on the leverage ratio requirements under Article 511 CRR. The Commission argued that those entities are not considered credit institutions under EU law and hence are not subject to the requirements of the CRR/CRD (vide rec. 3 in Annex II).

With regards to initial margin (Article 429c(4)), there seems to be no consensus among Members. Generally a minority of Member States support the proposal whilst some believe the provisions for initial margin are not in line with Basel and would prefer to wait for the Basel Committee to finalise the discussions.

Question

A number of Member States did not support the Commission`s Leverage Ratio proposal in relation to public development banks, officially guaranteed export credits and initial margin. Can Member States provide the reasons why they do not support these proposals and what alternative treatment they would support?[4]

[4] Some Member States also disagreed with the Commission's proposed exclusion from the exposure measure for guaranteed exposures arising from export credit. The Council's Export Credit Group will be circulating a note on this subject matter.

ANNEX I

Some relevant extracts from the Commission proposal for a Regulation amending CRR

"Article 6

General principles

1. Institutions shall comply with obligations laid down in Parts Two to Five, ***Seven*** *and Eight on an individual basis…."*

"Article 92

Own funds requirements

1. Subject to Articles 93 and 94, institutions shall at all times satisfy the following own funds requirements:

(a) a Common Equity Tier 1 capital ratio of 4,5 %;
(b) a Tier 1 capital ratio of 6 %;
(c) a total capital ratio of 8 %.
(d) a leverage ratio of 3% …"

"Article 429

Calculation of the leverage ratio

1. Institutions shall calculate their leverage ratio in accordance with the methodology set out in paragraphs ***~~2 to 11~~*** ***2 to 4.***

2. The leverage ratio shall be calculated as an institution's capital measure divided by that institution's total exposure measure and shall be expressed as a percentage.

Institutions shall calculate the leverage ratio ***~~as the simple arithmetic mean of the monthly leverage ratios over a quarter~~*** ***at the reporting reference date.***

3. For the purposes of paragraph 2, the capital measure shall be the Tier 1 capital.

~~4. The total exposure measure is the sum of the exposure values of all assets and off-balance sheet items not deducted when determining the capital measure referred to in paragraph 3.~~
~~Where institutions include a financial sector entity in which they hold a significant investment in accordance with Article 43 in their consolidation according to the applicable accounting framework, but not in their prudential consolidation in accordance with Chapter 2 of Title II of Part One, they shall~~

~~*determine the exposure value for the significant investment not in accordance with point (a) of paragraph 5 of this Article but as the amount that is obtained by multiplying the amount defined in point (a) of this subparagraph with the factor defined in point (b) of this subparagraph:*~~
~~*(a) the sum of the exposure values of all exposures of the financial sector entity in which the significant investment is held;*~~
~~*(b) for all direct, indirect and synthetic holdings of the institution of the Common Equity Tier 1 instruments of the financial sector entity, the total amount of such items not deducted pursuant to Article 47 and point (b) of Article 48(1) divided by the total amount of such items.*~~
~~*5. Institutions shall determine the exposure value of assets in accordance with the following principles:*~~
~~*6. Institutions shall determine the exposure value of contracts listed in Annex II and of credit derivatives including those that are off-balance sheet, in accordance with the method set out in Article 274.*~~
~~*In determining the exposure value of contracts listed in Annex II and of credit derivatives, institutions shall take into account the effects of contracts for novation and other netting agreements, except contractual cross-product netting agreements, in accordance with Article 295.*~~
~~*7. By way of derogation from paragraph 6, institutions may use the method set out in Article 275 to determine the exposure value of contracts listed in points 1 and 2 of Annex II only where they also use that method for determining the exposure value of those contracts for the purposes of meeting the own funds requirements set out in Article 92.*~~
~~*8. When determining the potential future credit exposure of credit derivatives, institutions shall apply the principles laid down in Article 299(2) to all their credit derivatives, not just those assigned to the trading book.*~~
~~*9. Institutions shall determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions including those that are off-balance sheet, in accordance with Article 220(1) to (3) and Article 222, and shall take into account the effects of master netting agreements, except contractual cross-product netting agreements, in accordance with Article 206.*~~
~~*10. Institutions shall determine the exposure value of off- balance sheet items, except the items referred to in paragraphs 6 and 9 of this Article, in accordance with Article 111(1), subject to the following amendments to the conversion factors listed in that Article:*~~
~~*(a) the conversion factor to be applied to the nominal value for undrawn credit facilities, which may be cancelled unconditionally at any time without notice, referred to in points 4(a) and (b) of Annex I, is 10 % ;EN 27.6.2013 Official Journal of the European Union L 176/253*~~
~~*(b) the conversion factor for medium/low risk trade finance related off-balance sheet items referred to in point 3(a) of Annex I and to officially supported export credits related off-balance sheet items referred to in point 3(b)(i) of Annex I is 20 % ;*~~
~~*(c) the conversion factor for medium risk trade finance related off-balance sheet items referred to in points 2(a) and 2(b)(i) of Annex I and to officially supported export credits related off-balance sheet items referred to in point 2(b)(ii) of Annex I is 50 % ;*~~
~~*(d) the conversion factor for all other off-balance sheet items listed in Annex I is 100 % .*~~

~~*11. Where national generally accepted accounting principles recognises fiduciary assets on balance sheet, in accordance with Article 10 of Directive 86/635/EEC, those assets may be excluded from the leverage ratio total exposure measure provided that they meet the criteria for non-recognition set out in International Accounting Standard (IAS) 39, as applicable under Regulation (EC) No 1606/2002, and, where applicable, the criteria for non-consolidation set out in International Financial Reporting Standard (IFRS) 10, as applicable under Regulation (EC) No 1606/2002.*~~

4. For the purposes of paragraph 2, the total exposure measure shall be the sum of the exposure values of:
(a) assets, excluding contracts listed in Annex II, credit derivatives and the positions defined in Article 429e, calculated in accordance with Article 429b(1);
(b) contracts listed in Annex II and credit derivatives, including those contracts and credit derivatives that are off-balance sheet, calculated in accordance with Articles 429c and 429d;
(c) add-ons for counterparty credit risk of SFTs, including those that are off-balance sheet, calculated in accordance with Article 429e;
(d) off-balance sheet items, excluding contracts listed in Annex II, credit derivatives, SFTs and positions defined in Articles 429d and 429g, calculated in accordance with Article 429f;
(e) regular-way purchases or sales awaiting settlement, calculated in accordance with Article 429g.
Institutions shall treat long settlement transactions in accordance with points (a) to (d) of the first subparagraph, as applicable.
Institutions may reduce the sum referred to in the first subparagraph by the total amount of general credit risk adjustments to on- and off-balance sheet items, subject to a floor of 0.

5. By way of derogation from point (d) of paragraph 4, the following shall apply:
(a) a derivative instrument that is considered an off-balance sheet item in accordance with point (d) of paragraph 4 but is treated as a derivative in accordance with the applicable accounting framework, shall be subject to the treatment set out in point (b) of paragraph 4;
(b) where a client of an institution acting as a clearing member enters directly into a derivative transaction with a CCP and the institution guarantees the performance of its client's trade exposures to the CCP arising from that transaction, the institution shall calculate its exposure resulting from the guarantee in accordance with point (b) of paragraph 4, as if that institution had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.
The treatment set out in point (b) of the first subparagraph shall also apply to an institution acting as a higher-level client that guarantees the performance of its client's trade exposures.
For the purposes of point (b) of the first subparagraph and of the second subparagraph, institutions may consider an affiliated entity as a client only

where that entity is outside the scope of regulatory consolidation at the level at which the requirement set out in Article 92(3)(d) is applied.

6. For the purposes of paragraph 4(e) of this Article and Article 429g, 'regular-way purchase or sale' means a purchase or a sale of a security under contracts for which the terms require delivery of the security within the time frame established generally by law or convention in the marketplace concerned.

Article 429a

Exposures excluded from the exposure measure

By way of derogation from point (a) of Article 429(4), an institution may exclude any of the following exposures from its exposure measure :

(a) the amounts deducted from Common Equity Tier 1 items in accordance with Article 36(1)(d);

(b) the assets deducted in the calculation of the capital measure referred to in Article 429(3);

(c) exposures that are assigned a risk weight of 0% in accordance with Article 113(6);

(d) where the institution is a public development credit institution, the exposures arising from assets that constitute claims on regional governments, local authorities or public sector entities in relation to public sector investments;

(e) exposures arising from passing-through promotional loans to other credit institutions granting the promotional loan;

(f) the guaranteed parts of exposures arising from export credits that meet both of the following conditions:

> *(i) the guarantee is provided by an export credit agency or by a central government;*
>
> *(ii) a 0% risk weight applies to the guaranteed part of the exposure in accordance with Article 114(4) or Article 116(4);*

(g) where the institution is a clearing member of a QCCP , the trade exposures of that institution, provided that they are cleared with that QCCP and meet the conditions laid down in point (c) of Article 306(1).

(h) where the institution is a higher-level client within a multi-level client structure, the trade exposures to the clearing member or to an entity that serves as a higher-level client to that institution, provided that the conditions laid down in Article 305(2) are met and provided that the institution is not obligated to reimburse its client for any losses suffered in the event of default of either the clearing member or the QCCP.

(i) fiduciary assets which meet all of the following conditions:

> *(i) they are recognised on the institution's balance sheet by national generally accepted accounting principles, in accordance with Article 10 of Directive 86/635/EEC;*
>
> *(ii) they meet the criteria for non-recognition set out in International Accounting Standard (IAS) 39, as applied in accordance with Regulation (EC) No 1606/2002;*
>
> *(iii) they meet the criteria for non-consolidation set out in International Financial Reporting Standard (IFRS) 10, as applied in accordance with Regulation (EC) No 1606/2002, where applicable.*

(j) exposures that meet all of the following conditions:

> *(i) they are exposures to a public sector entity;*
>
> *(ii) they are treated in accordance with Article 116(4);*
>
> *(iii) they arise from deposits that the institution is legally obliged to transfer to the public sector entity referred to in point (i) for the purposes of funding general interest investments;*

(k) the excess collateral deposited at triparty agents that has not been lent out;

(l) where under the applicable accounting framework an institution recognises the variation margin paid in cash to its counterparty as a receivable asset, the receivable asset provided that the conditions in points (a) to (e) of Article 429c(3) are met;

(m) the securitised exposures from traditional securitisations that meet the conditions for significant risk transfer laid down in Article 243.

2. For the purposes of point (d) of paragraph 1, public development credit institution means a credit institution that meets all of the following conditions:

(a) it has been established under public law by a Member State's central government, regional government or local authority;

(b) its activity is limited to advancing specified objectives of financial, social or economic public policy in accordance with the laws and provisions governing that institution, on a non-competitivebasis. For these purposes, public policy objectives may include the provision of financing for promotional or development purposes to specified economic sectors or geographical areas of the relevant Member State;

(c) its goal is not to maximise profit or market share;

(d) subject to state aid rules, the central government, regional government or local authority has an obligation to protect the credit institution's viability or directly or indirectly guarantees at least 90% of the credit institution's own funds requirements, funding requirements or exposures;

(e) it is precluded from accepting covered deposits as defined in point (5) of Article 2(1) of Directive 2014/49/EU or in the national law of Member States implementing that Directive.

3. Institutions shall not apply the treatment set out in points (g) and (h) of paragraph 1, where the condition in the last subparagraph of Article 429(5) is not met."

ANNEX II

RECOMMENDATIONS FROM THE EBA REPORT ON THE LEVERAGE RATIO REQUIREMENTS UNDER ARTICLE 511 OF THE CRR

Recommendation 1: In line with the agreement reached by the GHOS, a mandatory ('Pillar 1') minimum level of 3% should be introduced for the LR based on Tier 1 capital and this minimum requirement should generally apply to all credit institutions within the scope of the existing CRD IV/CRR requirements for LR, as applicable.

Recommendation 2: The international timetable, which envisages the application of the minimum level of 3% from 1 January 2018 onwards, should be followed; the EU banking sector has been preparing actively, and there does not seem to be a need for a longer transition as a general rule.

Recommendation 3: As a derogation to the general principle of recommendation 1, CCPs, as defined and regulated through Regulation (EU) No 648/2012 (EMIR) and in particular when holding a banking licence and thus being captured by the CRR requirements, should be exempted from an LR requirement.

Recommendation 4: As a derogation to the general principle of recommendation 1, CSDs, as defined and regulated through Regulation (EU) No 909/2014 (CSDR), should be exempted from an LR requirement.

Recommendation 5: Locally active savings and cooperative banks, as well as smaller credit institutions, also should be subject to the mandatory (Pillar 1) minimum level of 3%.

Recommendation 6: Higher LR requirements in the case of GSIIs may be warranted. Future developments at the level of the BCBS should be monitored carefully in terms of design and calibration of these additional requirements for GSIIs.

Recommendation 7: The LR numerator should consist of Tier 1 capital. A potential cap on the use of AT1 should be confined to GSIIs and should be in line with the eventual Basel standard. Any inclusion of (gone-concern) Tier 2 capital elements in the LR's capital measure by basing the calculation on total own funds would not be appropriate.

Recommendation 8: The EBA recommends no immediate changes to the calculation rules of the CRR LR with respect to areas mentioned in Article 511(3) of the CRR, which include the application of the OEM, the conversion factors for undrawn credit facilities which may be cancelled unconditionally at any time without notice and the Tier 1 capital measure. Future developments at the level of the BCBS should be monitored carefully in terms of the exposure measure.

Recommendation 9: Following the analysis described, and given the backstop nature of the LR, smaller banks should be subject to the same LR requirement as the rest of the banks.