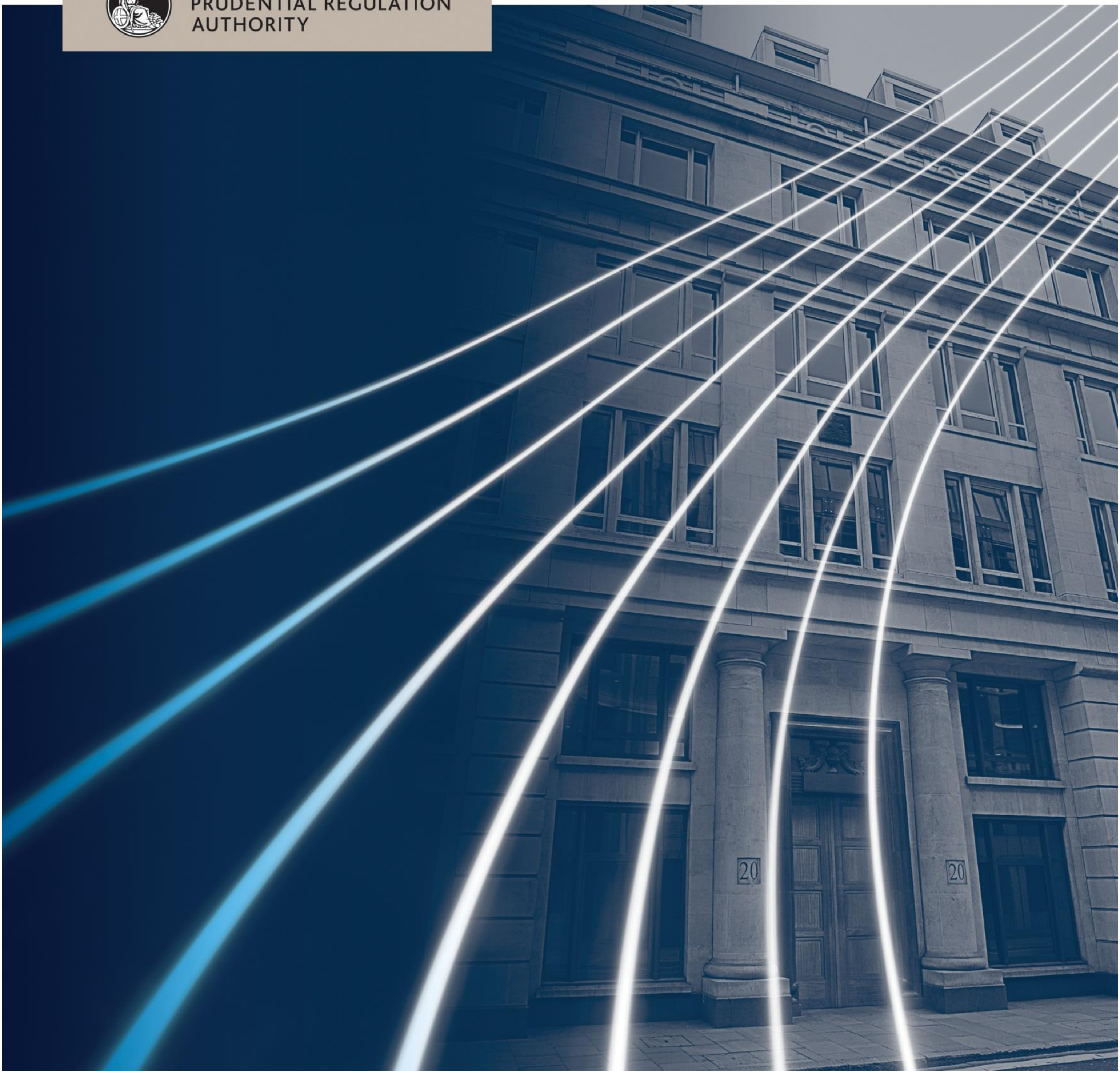
Policy Statement | PS21/17

UK leverage ratio: treatment of claims on central banks

October 2017

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to the responses to Consultation Paper (CP) 11/17 ' Consultations by the Financial Policy Committee (FPC) and PRA on changes to the UK leverage ratio framework relating to the treatment of claims on central banks'.[1]

1.2 This PS is relevant to PRA-regulated banks and building societies with retail deposits equal to or greater than £50 billion on an individual or a consolidated basis (hereafter 'firms').

1.3 At its meeting on 20 September 2017, and following consultation, the FPC recommended to the PRA that its rules on the leverage ratio:

(i) exclude from the calculation of the total exposure measure those assets constituting claims on central banks, where they are matched by deposits accepted by the firm that are denominated in the same currency and of identical or longer maturity; and

(ii) require a minimum leverage ratio of 3.25%.

1.4 Central bank claims for these purposes include reserves held by a firm at the central bank, banknotes and coins constituting legal currency in the jurisdiction of the central bank, and assets representing debt claims on the central bank with a maturity of no longer than three months.

1.5 In response to the FPC's Recommendation, and in line with CP11/17, the PRA is amending the PRA Rulebook and Supervisory Statement (SS) 46/15 'UK leverage ratio: instructions for completing data items FSA083 and FSA084' to:

(i) align them with its July 2016 modification by consent to exclude central bank claims matched by deposits in the same currency and of identical or longer maturity from the definition of the total leverage exposure measure in the UK leverage ratio framework;

(ii) increase the minimum leverage ratio requirement from 3% to 3.25% of total exposures; and

(iii) align the UK leverage ratio reporting and disclosure requirements to the proposed definition of the total exposure measure and 3.25% minimum leverage ratio requirement.

1.6 Following consultation, in the absence of significant concerns raised, there have been no changes to the proposals. However, the PRA wishes to provide clarification on some issues raised in the responses. These are set out in Chapter 2.

1.7 In order to implement the FPC's Recommendation, the PRA is amending its Rulebook and SS46/15 as set out in paragraph 1.5 above. The appendices below set out the updated versions of the relevant documents.

1.8 These reporting changes come into effect immediately, so will apply to firms' reporting and disclosure requirements for end-December 2017 onwards.

1 June 2017: www.bankofengland.co.uk/pra/Pages/publications/cp/2017/cp1117.aspx.

1.9 The revised definition of the total exposure measure will flow through to firms' obligations with regard to the leverage ratio reporting and disclosure requirements.

1.10 Firms will have to report to the PRA, but not disclose publicly, the total amount of central bank claims being excluded from the total exposure measure, including a specification of the amount of Bank of England claims in sterling that are being excluded.

1.11 For leverage reporting and disclosure obligations under the Capital Requirements Regulation (EU) 575/2013 (CRR), CRR firms are required to use the total exposure measure definition set out in Article 429(4) of the CRR.

1.12 A credible disclosure regime promotes market discipline. The PRA considers that these proposed amendments allow the PRA to monitor firms' leverage ratios and will make clear to the public the standard against which the PRA is supervising firms.

2 Feedback to responses

2.1 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them.

2.2 The FPC and PRA consultations received four responses from banks and industry associations representing financial services firms. Respondents broadly supported the exclusion of claims on central banks in the leverage exposure measure in principle. Some responses raised concerns about aspects of the proposed recalibration of the minimum leverage ratio requirement, and alignment of UK leverage ratio disclosure and reporting requirements. These responses have informed the PRA's final consideration in amending its Rulebook and SS46/15 as proposed in the CP.

2.3 The PRA response to the feedback has been grouped by topic below. The FPC response can be found in the updated FPC leverage ratio policy statement.[1]

Timing of changes in relation to international standards

2.4 Respondents questioned how the proposed changes to the UK leverage ratio framework would interact with the finalisation in Basel of an international leverage ratio standard and developments in EU legislation. Some respondents were concerned about changes being made in the UK at this time that might need further amendment.

2.5 The FPC had set out its intention in July 2016 to consult and decide on the appropriate form of recalibration of UK leverage ratio capital requirements to adjust for the impact of the exclusion of central bank reserves in 2017. The timing of the recalibration allowed the Bank to reflect the new minimum leverage ratio in its 2017 stress test, as announced in the Bank's 2017 stress test scenario publication. This policy has been designed in the context of the current UK, EU and international regulatory frameworks and international discussions on the treatment of central bank reserves in the leverage ratio.

Scope of application and future FPC reviews of the UK leverage ratio framework

2.6 Some respondents sought clarification as to whether the recalibrated minimum leverage ratio requirement would become applicable to other PRA-regulated firms, and at different levels of consolidation, in due course. Relatedly, some respondents were concerned that

1 http://www.bankofengland.co.uk/financialstability/Documents/fpc/policystatement010715ltr.pdf.

where the changes would lead to firms disclosing multiple leverage ratios, this would reduce comparability across firms.

2.7 The FPC's recommendation relates only to the UK banks and building societies to which the Leverage Ratio Part of the PRA Rulebook applies (ie those with retail deposits equal to or greater than £50 billion on an individual or consolidated basis); currently those firms have to comply with that framework on the basis of their consolidated situation. The FPC will be conducting a comprehensive review of the elements of the leverage ratio framework in 2018, including the level and scope of application.

Definitions

2.8 Some respondents sought clarification on the definition of central bank claims to be excluded, and suggested broadening the scope of eligible claims and the definition of deposits.

2.9 As set out in CP11/17, 'The PRA [will] exclude claims on central banks from the calculation of the total leverage exposure measure, where they are matched by deposits accepted by the firm that are denominated in the same currency and of identical or longer maturity. Central bank claims for these purposes include reserves held by a firm at the central bank, banknotes and coins constituting legal currency in the jurisdiction of the central bank, and assets representing debt claims on the central bank with a maturity of no longer than three months.'

2.10 The meaning of 'deposit' for these purposes is the same as in the Leverage Ratio Part of the PRA Rulebook.

2.11 The FPC's primary intention with these changes is to ensure that leverage ratio capital requirements do not impede the effective transmission of monetary policy. The exclusion of instruments with short original maturity used to implement monetary policy is sufficient at this time to meet this objective.

Interaction with the MREL framework

2.12 Some respondents were concerned about the implications of changes to the UK leverage ratio framework for minimum requirement for own funds and eligible liabilities (MREL), and sought clarity on the interaction between the two frameworks.

2.13 The Bank as resolution authority has set out that it expects firms that are subject to a bail-in or partial transfer preferred resolution strategy to meet an end-state MREL from 1 January 2022 based on two times their regulatory capital requirements, ie 2 x (Pillar 1 plus Pillar 2A) or 2 x any applicable leverage ratio requirement.[1] There are interim requirements that apply to Global Systemically Important Institutions (G-SIIs) from 1 January 2019 and for all firms subject to MREL above capital requirements from 1 January 2020. See the MREL statement of policy for further details.[2] Consistent with MREL being calibrated by reference to an institution's regulatory capital requirements, the FPC's proposed changes would apply to the applicable leverage ratio requirement used in setting a firm's MREL, restoring the intended level of resilience.

1 For G-SIIs, in terms of leverage, MREL must be the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures. Note that for partial transfer firms, MREL might be reduced to reflect the fact that less than the entire balance sheet of the institution will need to be recapitalised at the point of resolution.

2 November 2016: www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf. Proposals in respect of 'internal MREL' and amendments to the statement of policy to address those were also consulted on by the Bank, see http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelconsultation2017.pdf.

2.14 As acknowledged in FPC the consultation, for firms that held relatively low levels of central bank reserves, the changes might mean a small increase in MREL, in particular during transitional arrangements when the leverage ratio may determine firms' MREL. However, the impact is dampened as end-point MREL for most firms is likely to be constrained by the risk-weighted capital framework. The PRA agrees with this assessment.

Cost benefit analysis

2.15 Some respondents raised concerns about the potential effect of the change on firms' incentives to undertake low-risk weight, low-return activities, such as the provision of repo financing.

2.16 As set out in the consultation, the PRA agreed with the FPC's assessment that the potential impact is small. Furthermore, as indicated by the recent report on Repo Market Functioning by the Committee on the Global Financial System,[1] repo markets are in a state of transition and differ across jurisdictions in terms of both their structure and their functioning. As a result the impact on activities of regulation, including leverage ratio requirements, merits ongoing monitoring.

2.17 The evidence provided does not affect the costs benefits analysis set out in the consultation which concluded that the changes would provide benefits to financial stability and economic growth.

2.18 A respondent noted that the cost of recalibration was greater for mutuals. As set out in the consultation, the PRA acknowledges that mutual may face particular challenges and costs when raising Tier 1 capital externally when compared to banks. As a result, the proposals could potentially affect the former disproportionately. However, in practice, the PRA expects all impacted firms to have sufficient capital resources to meet the new requirements, including the one mutual in scope of the UK leverage ratio framework.

1 www.bis.org/publ/cgfs59.htm.

Appendices

1	**LEVERAGE RATIO AND REPORTING LEVERAGE RATIO (AMENDMENT) INSTRUMENT [2017], available at: www.bankofengland.co.uk/pra/Pages/publications/ps/2017/ps2117.aspx**
2	**Supervisory Statement 46/15 UPDATE 'UK leverage ratio: instructions for completing data items FSA083 and FSA084', available at: www.bankofengland.co.uk/pra/Pages/publications/ss/2017/ss4615update.aspx**
3	**FSA083 leverage ratio template, available at: www.bankofengland.co.uk/pra/Pages/regulatorydata/formscrdfirms.aspx**
4	**Instructions of FSA083 leverage ratio template, available at: www.bankofengland.co.uk/pra/Pages/regulatorydata/formscrdfirms.aspx**