Introduction
The European Commission’s proposal for a Directive and Regulation (collectively known as CRD IV) will replace the existing Capital Requirements Directive and implement the Basel III accord in Europe. Basel III introduces the Leverage Ratio as a non-risk based approach to the measurement of leverage, to act as a 'backstop' and thereby mitigate the regulatory and other model uncertainties that can arise from risk-based approaches.

The Leverage Ratio is a measure of the capital of an institution as a proportion of total adjusted assets. More specifically, it has been defined as the ratio of the average of the monthly leverage ratio over the quarter based on Tier 1 capital and the total exposure. The Leverage Ratio proposed by the Basel Committee is calibrated at 3%. This means that an institution’s gross borrowings should not be more than 33 times the institution’s Tier 1 capital.

For more detail on the Leverage Ratio under Basel III please see the AFME Briefing Note on the Leverage Ratio.

CRD IV Overview
While CRD IV requires that institutions calculate their leverage ratios, unlike Basel III it does not propose a minimum leverage ratio. The European Banking Authority (EBA) is required to report to the European Commission by 31 October 2016 whether 3% is an appropriate level for the leverage ratio based on Tier 1 capital, and if not, what would be the appropriate level.

Institutions are required to disclose their leverage ratios and other ancillary information from 1 January 2015. However, from 1 January 2013 the leverage ratio and changes to it will be monitored by firms as part of Pillar 2 under their Internal Capital Adequacy Assessment Processes (ICAAPs), and will be included in Supervisory Review and Evaluation Processes (SREP) – the oversight by regulators. Detailed requirements for calculating the leverage ratio are included in CRD IV.

AFME’s Positions
Observation Period*
AFME welcomes the approach taken in the CRD IV to the leverage ratio requirements where potential impacts on business models and business sizes are to be considered by the Commission by December 2016 before the final determination of the ratio as a backstop. AFME recommends maintaining the consideration of the leverage ratio under Pillar 2 requirements.
Disclosure*
AFME has concerns about requirements for institutions to disclose leverage ratios before the design and calibration are finalised. Such disclosure could be based upon inconsistent design and could be misleading to the market.

Individual Basis vs. Consolidated Basis*
CRD IV requires compliance with the Leverage Ratio on the legal entity level (CRR Art. 5). Institutions should be able to obtain waivers to apply the provisions on a consolidated basis.

Impact on Trade Finance and Commitments and the Broader Economy*
CRD IV introduces conversion factors for off-balance sheet exposures that could have an impact on several types of businesses, including trade finance and the broader economy. Undrawn facilities not considered unconditionally cancellable would, for example, be converted at a 100% rate. For trade finance, for instance, conversion at 100% far exceeds actual experience. The implementation period should be used to develop conversion factors that are more aligned to expected usage.

Pillar 3 Templates*
The EBA is tasked with developing technical standards for ‘uniform disclosure’ under the Pillar 3 disclosure for leverage. This is contrary to the way Pillar 3 disclosure has operated, where institutions have discretion about the format in which information is presented. The current discretion which institutions have with regards to format for Pillar 3 disclosures should be retained.

* CRD IV and Basel III issue
+ Issue specific to CRD IV

Further information
AFME has broken down positions on the key CRD IV issues in more specific briefing notes:

- Overview of CRD IV
- Capital and Capital Buffers
- Counterparty Credit Risk
- Liquidity

See also AFME’s material covering Basel III:

- Overview of Capital Requirements Reform

All of these documents are available on the AFME website

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