

A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on BCBS consultative document “Revision to the Basel III leverage ratio framework” issued in April 2016.

DBG is operating in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A., Luxembourg (CBL) and Clearstream Banking AG, Frankfurt/Main (CBF), who act as (I)CSD¹ as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are classified as credit institutions and are therefore within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transpose i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

However, all our group entities in scope of CRD / CRR and therefore Basel rules (including the leverage ratio) are offering limited banking activities ancillary to their function as Financial Market Infrastructure (FMI). In order to operate as a Financial Market Infrastructure and in line with the dedicated regulatory framework (e.g. CPSS-IOSCO principles for financial market infrastructures as of April 2012) as well as generally recognised business practices, the business model of our group entities is risk averse, does not include a trading book / proprietary trading, allows loan business only in connection with clearing, settlement and custody activities for very short durations and in general on a collateralised basis and does not lead to intended financial leverage. Cash received out of the functions of our companies is based on the sole discretion of the clients². It is invested with low credit risk and to a large degree without maturity transformation. Existing maturity transformation (strictly limited for CCPs) is done based on proper liquidity management principles and not driven by intention to gear net interest income. Contrary, interest paid on clients' deposits is very limited independent of the level of interest rates. For the CCP

¹ (International) Central Securities Depository

² Margin / collateral requirements may be fulfilled by either cash or securities to the discretion of the client.

business collateral taken is the consequence of the general political preference for CCP cleared business especially for financial derivatives. In order to secure sufficient liquidity for the CCP function at any time a preference for cash collateral received in comparison to other forms of collateral (e.g. securities) is inherent in the business model. In addition, due to highly automated processes operational risk is limited to the extent possible.

The document at hand contains a management summary in part B and specific comments on the consultative document in part C.

B. Management Summary

We already addressed our concerns about the leverage ratio framework several times e.g. in the BCBS consultation in 2013³. Although we appreciate that some of our concerns had been taken into account several other issues are still valid and require adjustments which we outline in this document again.

In particular we continue to have general doubts that the non-risk sensitive leverage ratio with simple calculation basics and unique treatments will add benefits in limiting possible bank failures.

A flat and unique leverage ratio of 3% will unintentionally dis-incentivise low risk business and most likely harm risk reducing businesses / activities. As such we see the need to at least calibrate the ratio calculation in further areas which however contradicts the general approach of simple and unique calculation. In this regard we also disagree to base TLAC requirements on the amount of total liabilities and weighted off-balance sheet positions for more or less the same reasons.

In particular an application of the leverage ratio to the dedicated business of FMI does not seem to be meaningful at all.

In case applied to FMIs (e.g. for CCPs and / or CSDs with ancillary banking business being as legal entity in scope of the Basel rules), at least an adequate reflection of the dedicated business needs to be assured. Therefore we encourage the BCBS to foresee the principle of proportionality and dedicated treatment for specific businesses like FMIs, e.g. by:

1. Allowing the elimination of client cash holding in relation to the FMI business (cash collaterals for CCPs and cash deposits for cash settlements at CSDs) from the exposure measure;
2. Allowing (at least as a national discretion or as a discretion to the national competent authority) to vary the levels of the leverage ratio depending on the business model.

We do not consider the application of alternative 2 only as a sufficient solution for FMIs as the balance sheet of FMIs is highly volatile and will lead to subsequent volatile leverage ratios. While FMIs do not have an intended financial leverage and

³ See <http://www.bis.org/publ/bcbs251/deutschebrsegro.pdf>

due to regulatory constraints are not in a position to steer the balance sheet, consequently the leverage ratio related disclosure will mislead the market.

We welcome the different treatment of CCP cleared transactions and non centrally cleared transactions.

We strongly agree to the replacement of the Current Exposure Measure (CEM) by the Standardised Approach for measuring counterparty credit risk exposures (SA-CCR). Nevertheless we notice some uncertainty in the market whether the SA-CCR also to be used for leverage ratio purposes. It is our firm understanding that this is the case and the consultative paper in our view is only seeking views to confirm this approach.

By the introduction of the SA-CCR collateralisation and centrally cleared transactions are treated more adequately.

Similarly market makers in securities or derivatives hold a position in the respective asset in order to fulfil their market maker role. In order to protect themselves they enter into hedging agreements. The current usage of CEM for leverage ratio purposes does not allow to net these positions. It is our understanding that under SA-CCR an adequate netting is possible and therefore the problem should disappear as of 1 January 2017 under the revised BCBS rules for the leverage ratio in case applied as proposed. This further highlights the need to replace the CEM with the SA-CCR to ensure prevention of adverse effects on the markets. For those market makers it must be possible to fully net those underlying exposures with the respective hedging instruments.

Having said this, unfortunately a negative impact on client clearing business remains to some extent even under the SA-CCR. Clearing Member being engaged in client clearing and as such economically more or less pass the client business through to the CCP, still receive a charge for the leverage ratio which is deemed not appropriate. However, we positively recognise the improvements made in this regards with the current SA-CCR approach.

Both elements (client clearing and market makers) require adequate treatment in order to avoid negative consequences on efficient and risk balanced financial markets.

Further, we in general agree to the proposed treatment for on-balance sheet exposures and SFT businesses, in particular the possibility to net payables and

receivables under certain conditions. Nevertheless, we see the need for some adjustments with regards to the proposed SFT treatments.

All in all, we continue to have remarks in a variety of areas which can be summarized as follows:

- The capital base for the leverage ratio should be total regulatory capital instead of Tier 1 capital;
- There exist solutions for the CCP clearing which transfer any transaction on an item by item basis (gross transfer) or on a netted basis (net transfer). Therefore it should be secured that the treatment of CCP positions is done equally regardless of the underlying CCP concept if no economic difference exists;
- The treatment of derivative positions cleared via a CCP should also be applied for such transactions which are originating from clients and are “passed through”. Therefore neither the CCP leg nor the client leg should be included in the leverage ratio of the Clearing Member;
- For derivative transactions of Clearing Members on behalf of their clients via a CCP in a segregated model provided collateral is not available to the Clearing Member and should therefore not be included in the exposure measure;
- We agree to treat Securities Financing Transactions (SFTs) equally regardless of the applicable accounting standard, otherwise the leverage ratio lacks on comparability. Nevertheless we see several details where adjustments are required;
- While we agree not to consider exposure reduction by collateral received, we disagree to increase exposures by the amount of any potential collateral value gap for SFT transactions. Uncollateralised transactions (i.e. uncollateralised placements) should not have a lower exposure value (E) than partially collateralised exposures ($E + (E-C^4)$);
- The treatment of banks operating as agents in SFT transactions needs refinement (e.g. treatment of guarantees which are fully collateralised, banks acting as agent without any financial guarantee, etc.);

⁴ Collateralisation

- The intended treatment of regular-way purchases and sales of financial assets and the acknowledgment of trade date accounting versus settlement date accounting may lead to an unintended double counting that must be prevented.

We cover some of these aspects, beside others, in part C below and refer for the rest to our statement of the consultation BCBS #251⁵.

⁵ See <http://www.bis.org/publ/bcbs251/deutschebrsegro.pdf>

C. Dedicated remarks to the proposed revisions

1. Definition and minimum requirements:

We continue to express our critical position towards the concept of the leverage ratio and our general rejection of the introduction of the leverage ratio as a binding limit especially for FMIs, independent of whether they operate with an additional banking licence or not. Low risk / high volume businesses are dis-incentivised while business models accepting significantly higher risks per invested EUR should not be breaching the leverage ratio. **The leverage ratio is not an appropriate measure for FMIs.**

We disagree to a fixation of a flat 3% as a Pillar I limit starting in 2018 as this might impact various business models to an unintended degree and also impacts smaller, private banking oriented banks with low to non trading activities e.g. savings banks as well as small subsidiaries within internationally active banking groups. Per se a more differentiated approach seems to be sound with less negative implications on the financial system.

2. Capital base

We are in favour of the usage of total regulatory capital as capital base. From our perspective the coverage of assets is given by any component of the total regulatory capital. To exclude Tier 2 capital instruments does not seem reasonable.

In case the capital base will be extended and Tier 2 instruments might be included as well, institutions which rely to a large extend or even fully on Common Equity Tier 1 may not be dis-incentivised by increasing the overall limit or not reducing the limit for these institutions.

3. Treatment of Derivatives:

In general we agree to the treatment of derivatives in the leverage ratio, in particular the replacement of CEM by SA-CCR.

Nevertheless, we urge the BCBS to honour the role of Clearing Members to provide access to CCPs for clients that have no direct access. In case those exposures of the Clearing Members towards the CCP and the clients are included in their own leverage ratio exposure measure, although the trades are only passed-through, this is dis-incentivising centrally clearing and makes it more expensive for clients to have a CCP access. In order to improve the market stability in general this should be

prevented. This is also true with regards to client collaterals passed through by the Clearing Members to the CCP.

4. Market makers:

An important point of attention is the effect of the current leverage ratio framework using the CEM on market makers being in scope of leverage ratio requirements and related limits going forward.

Market makers in securities or derivatives hold a position in the respective asset in order to fulfil their market maker role. In order to protect themselves they enter into hedging agreements. The current framework under CEM does not allow to net these positions, and moreover leads to situations where a hedged position has a higher leverage ratio driven capital requirement than an outright unhedged position.

The resulting additional capital requirements make the business model of a market maker prohibitively costly and with little choice but to recede from markets by giving up their role as a market maker. Therefore, markets would be faced with the threat of loss in liquidity which would be detrimental for the markets, especially in the verge of promoting growth for European markets. The SA-CCR is taking up most of the issue. Therefore we urge the BCBS to follow its plan to replace the CEM by SA-CCR also for the leverage ratio framework and consider the topic whenever developing its capital framework further.

5. Exposure measure

With regard to the treatment of regular-way purchases and sales of financial assets and the acknowledgement of trade date accounting versus settlement date accounting we want to express our concerns that the proposed conduct of options A and B in paragraph 16 might lead to an unintended and non adequate treatment as exposures may be double counted for the exposure measure of the leverage ratio.

We understand the aim to align the calculation method of the leverage ratio in case applied GAAPs are different. Nevertheless, we propose to keep the balance sheet value as there is no material difference in the exposures between settlement date accounting and trade date accounting. The only difference is the kind of assets shown (i.e. cash or securities) and fluctuations in the market value depending on the accounting treatment may have to be considered but are supposed to be immaterial in general.

Consequently, we disagree to option A, which in the case of a purchase, would add the purchase price or market value of the purchased securities with a Credit Conversion Factor (CCF) of 100% to the total exposure value (Off balance sheet item) while the cash remains in the exposure value (double counting), in case settlement date accounting is used.

Similarly in case of trade date accounting cash to be paid for purchases is to be recognised on top of the already recognised value of the purchased securities. In this regard off-setting payment obligations in the context of sales and purchases are required to be grossed up. Again, this demonstrates double counting.

We do not see any advantage in option B which adds further complexity.

Under settlement date accounting for a purchase the cash position stays in the balance sheet and in case of a failed trade nothing happens at all. Further, under trade date accounting the cash receivable for a sale stays in the balance sheet until fulfilment or ultimate fail of the transaction. The underlying securities remain in the possession of the seller. Depending on the accounting standard and the kind of transaction (purchase or sale) impacts of mark-to-market adjustments may lead to changes in the asset / exposure value, which may be corrected via a provision for possible losses or may not be recognised at all. As mark-to-market is only applicable for certain assets and taking the general principle of simplicity into account we propose not to adjust the accounting values with mark-to-market adjustments.

Having said this, in case the BCBS contrary to our position wants to harmonise the asset values only an adequate adjustment from market fluctuations should be considered.

Under the general capital requirements framework the settlement risks in the standard settlement periods are not captured. As such, even the BCBS seems to recognise the low materiality of market fluctuations between trade date and settlement date. In our view this confirms the approach to not adjust the accounting values.

Therefore, for the sake of simplicity and taking an adequate risk sensitivity into account no adjustment at all is the most appropriate approach.

6. Other off-balance sheet exposures

On other off-balance sheet items described in paragraph 43 to paragraph 45 of the proposal shall be applied a 100% CCF, with an exceptional treatment of 10% to 20% CCF for any commitments that are unconditionally cancellable at any time by the bank without prior notice towards retail clients (see paragraph 13 of the Annex). We propose to apply a 0% CCF instead in line with the current framework for general credit risk. We refer in this regard to our comments made in the BCBS consultation on the "Review to the Standardised Approach for Credit Risk"⁶. In addition, in no case the CCF for such exposures to other financial institutions should be higher than the CCF for retail commitments. This would harm the interbanking markets.

7. Securities financing transaction (SFT) exposures

Bank acting as a principal:

Uncollateralised placements are taken into account with their on-balance sheet value only. While we agree that in line with the concept of the leverage ratio collaterals received are not reducing the exposure value **we however strongly disagree to increase the exposure value of SFT transactions by any portion which is not collateralised**. This would not only dis-incentivise collateralised SFT transactions especially with regard to cash placements but also economically overstate the risk while in practise the risk is lower. This effect results out of the potentially add-on of the value difference of exposure versus collateral, i.e. the exposure value of an SFT may be $E + (E-C)$ whereas the exposure value of an uncollateralised placement would be E only. **Therefore we strongly disagree with the treatment of paragraph 37 (ii)**.

In addition, we kindly ask to include in the final paper a clarification what is meant with E (Exposure) and C (Collateral) including the treatment of the valuation i.e. market value.

The proposed treatment of master netting agreements (in the following MNA) seems to be too restrictive for such kind of arrangements. It is quite common for SFT business and in particular for the securities lending market to collateralise a variety of loans (loan portfolio) with a pool of collaterals. Such collateralisation has various legal concepts and is not necessarily a MNA. As such, the Committee should ensure

⁶ See <http://www.bis.org/bcbs/publ/comments/d347/deutschebrsegro.pdf>

that all kinds of similar agreements which are legally enforceable in case of a borrower default are treated the same. An artificial allocation of collateral is only the second best solution.

Bank acting as an agent:

Paragraph 39 assumes that in SFT transactions where a bank acting as an agent is generally providing an indemnity or guarantee for any difference between the securities or cash and the value of the related collateral. However to our knowledge at least two other models are frequently used:

1. The bank is only acting operationally as an agent and is not guaranteeing at all the value of any collateral or exposure;
2. The bank is guaranteeing the full amount of the transaction while being collateralised to 100% plus an adequate haircut.

While we do not see any need to include “exposures” out of models as described in number 1, we expect equal treatment of the economical subsense of exposures out of models as described in number 2 with the proposed treatment of items as described (i.a. treatment in accordance with paragraph 38) in paragraph 37. In consequence, only a remaining exposure value after deduction of the received collateral should be taken into account. Consequently, the context of paragraph 39 needs to be adjusted.

As stated above, with regards to FMIs operating with a banking license, we recommend a general exclusion from the leverage ratio framework. However, if the BCBS does not agree to this proposal we, similar to our argumentation in the derivatives exposure section, are at least proposing a specific treatment for CCPs acting in the SFT business. In case such CCP itself has to achieve the leverage ratio the SFT position as such should not be included in the exposure measure at the CCP regardless of the accounting treatment. Furthermore, any collateral received by such CCP should also be excluded from the exposure measure as described in the derivative section above.

We hope that our comments given are useful in the further process and are taken up going forward. We are happy to discuss any question related to the comments made.

Eschborn

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