BANK OF ENGLAND

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Consultations by the FPC and PRA on changes to the UK leverage ratio framework relating to the treatment of claims on central banks

An FPC Consultation Paper | PRA Consultation Paper CP11/17

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Responses are requested by Tuesday 12 September 2017.

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1 Overview

1.1 This document contains two consultations.

1.2 The first consultation sets out the Financial Policy Committee's (FPC) proposed Recommendation to the Prudential Regulation Authority (PRA) to exclude claims on central banks from the leverage exposure measure in the UK leverage ratio framework; and compensate for the resulting reduction in capital needed to meet the leverage ratio minimum requirement and leverage ratio buffers (henceforth 'leverage ratio capital requirements'), by increasing the minimum requirement from 3% to 3.25%.

1.3 The second consultation (PRA Consultation Paper 11/17) sets out the PRA's proposals for implementing the FPC's proposed Recommendation – should it be adopted by the FPC.

1.4 These consultations are 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').

1.5 The proposals aim to ensure that the leverage ratio framework does not act as a barrier to the effective implementation of any monetary policy action that leads to an increase in central bank reserves. The proposals could also increase the financial sector's ability to draw on central bank facilities as necessary, and in turn, cushion shocks to the financial system and to the provision of credit to the real economy.

1.6 Comments on the proposed FPC Recommendation set out in Section 2 (pages 7 to 12), and on how the PRA would implement the Recommendation set out in Section 3 (pages 13 to 25) may be included in a single response. All responses should be emailed to leverageratiochanges@bankofengland.co.uk by Tuesday 12 September 2017.

1.7 The policy has been designed in the context of the current UK and EU regulatory framework. It will be kept under review to assess whether any changes would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect.

Background

1.8 In July 2016, the FPC recommended to the PRA that when applying its rules on the leverage ratio the PRA considers allowing firms to 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.[1] In response, the PRA invited firms to apply for a temporary rule modification in order to allow the exclusion of claims on central banks from the total exposure measure used to calculate UK leverage ratio capital requirements.[2]

1.9 The FPC recognised that, absent offsetting the impact of this change, excluding central bank reserves from the exposure measure – the denominator of the leverage ratio – mechanically reduced the amount of capital needed to meet leverage ratio capital requirements at the time, other things being equal. This was not the FPC's intention. It

1 www.bankofengland.co.uk/publications/Pages/news/2016/062.aspx.

2 Modification by Consent to Leverage Ratio rule 1.2, Public Disclosure rule 1.1 and Reporting Leverage Ratio rule 1.2 available at www.bankofengland.co.uk/pra/Pages/authorisations/waivers/waiversbyconsent.aspx.

therefore said that it intended to recalibrate UK leverage ratio capital requirements to offset this impact, which the PRA welcomed.

Summary of proposals

FPC consultation

1.10 The FPC proposes to recommend 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%.

1.11 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.

1.12 The FPC consultation seeks feedback on the proposed FPC Recommendation to the PRA.

PRA consultation – CP11/17

1.13 In response, should the FPC's Recommendation be adopted, the PRA proposes to amend the PRA Rulebook and Supervisory Statement (SS) 'UK leverage ratio: instructions for completing data items FSA083 and FSA084 – SS46/15'[1] 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.

1.14 The PRA seeks feedback on its proposed approach to implementing the proposed FPC Recommendation to the PRA.

1 UK leverage ratio: instructions for completing data items FSA083 and FSA084, December 2015, available at www.bankofengland.co.uk/pra/Pages/publications/ss/2015/ss4615.aspx.

2 FPC Consultation Paper

The FPC and its regulatory powers

2.1 The FPC was established under the Bank of England Act 1998, through amendments made in the Financial Services Act 2012. It is responsible for protecting and enhancing the resilience of the UK financial system, including identifying, monitoring, and taking action to remove, or reduce, systemic risks. But the FPC is not required to achieve resilience at any cost. Its actions must not, in the provisions of the legislation, have a 'significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term'. Subject to achieving its main objective, the FPC is required to support the Government's economic policy, including its objectives for growth and employment. The FPC has two main powers under the legislation. It can make Recommendations to anybody, including to the PRA and the Financial Conduct Authority (FCA). It can also give Directions to those regulators to implement a specific measure to further the FPC's objectives.

2.2 In July 2016, the FPC recommended to the PRA that, when applying its rules on the leverage ratio, it considers allowing firms to exclude from the calculation of the total exposure measure certain claims on central banks. The FPC agreed to revoke its existing Direction to the PRA on the UK leverage ratio framework, in order to allow the PRA to implement the FPC's Recommendation with immediate effect. At the time, the FPC set out its intention 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. Following this, the PRA offered a voluntary modification of the leverage exposure measure to firms in scope of the UK leverage ratio framework, and welcomed the FPC's intention to recalibrate.[1]

FPC proposal

2.3 The FPC proposes to recommend 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%.

2.4 This Recommendation would be a change to the approach the FPC set out in its Policy Statement 'the Financial Policy's Committee's powers over the leverage ratio tools'.[2]

2.5 The FPC seeks industry feedback on the proposed FPC Recommendation to the PRA.

(i) Excluding central bank claims from the leverage exposure measure

2.6 The first part of the FPC's proposal recommends that the PRA 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.

1 See www.bankofengland.co.uk/pra/Documents/publications/reports/prastatement0816.pdf. The PRA offered a variation of the modification by consent in January 2017 which aligned leverage reporting and disclosure requirements with the new definition of the total exposure measure. Modification by Consent to Leverage Ratio rule 1.2, Public Disclosure rule 1.1 and Reporting Leverage Ratio rule 1.2 is available at www.bankofengland.co.uk/pra/Pages/authorisations/waivers/waiversbyconsent.aspx.

2 This Policy Statement relates to the FPC's Powers of Direction over leverage ratio tools. The FPC's existing powers of Direction do not enable it to vary the exposure measure used to calculate the leverage ratio. www.bankofengland.co.uk/financialstability/Documents/fpc/policystatement010715ltr.pdf.

2.7 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.

2.8 As set out in the FPC's 2015 Policy Statement on the UK leverage ratio framework, which has been in effect since January 2016, UK leverage ratio capital requirements used the definition of 'total exposure measure' agreed by Basel in 2014 and adopted in European law.[1]

2.9 The FPC's July 2016 Recommendation was intended to ensure that the leverage ratio framework does not act as a barrier to the effective implementation of any policy measures that lead to an increase in claims on central banks, in particular an increase in central bank reserves.

2.10 Including central bank reserves in the leverage exposure measure could have unintended consequences. In circumstances where firms' balance sheets increase because of an expansion in central bank balance sheets, regulatory leverage ratio capital requirements could effectively tighten. This could prompt firms to deleverage by shedding assets, cutting their supply of credit, or withdrawing from other activities.

2.11 It could also act as a disincentive for firms to use central bank liquidity facilities. This could affect the ability of the banking system to cushion shocks, and to maintain the supply of credit to the real economy and support for market functioning.

2.12 At the same time, central bank reserves are a unique asset class because they are the ultimate settlement asset. If matched by liabilities in the same currency and of identical or longer maturity, they typically do not represent an exposure to risk. Therefore, there is no need to build resilience against holdings of reserves.

(ii) Adjusting the leverage ratio calibration

2.13 The second part of the FPC's proposal recommends that, when applying its rules on the leverage ratio, the PRA increases the minimum leverage ratio requirement by 25 basis points, from 3% to 3.25% of total exposures excluding central bank reserves.

2.14 The FPC recognises that, absent any offsetting change, excluding central bank reserves from the exposure measure reduces the amount of capital needed to meet leverage ratio capital requirements. The FPC was clear in its July 2016 Record that its intention was not to alter the level of resilience as a result of adjusting the definition of the exposure measure.

2.15 When setting leverage ratio capital requirements in 2014 and 2015, central bank balance sheets had already expanded to high levels. Since 2009, there has been a significant increase in central bank balance sheets as share of GDP in advanced economies (**Chart 1**), in particular reflecting the role of asset purchases within monetary policy frameworks.

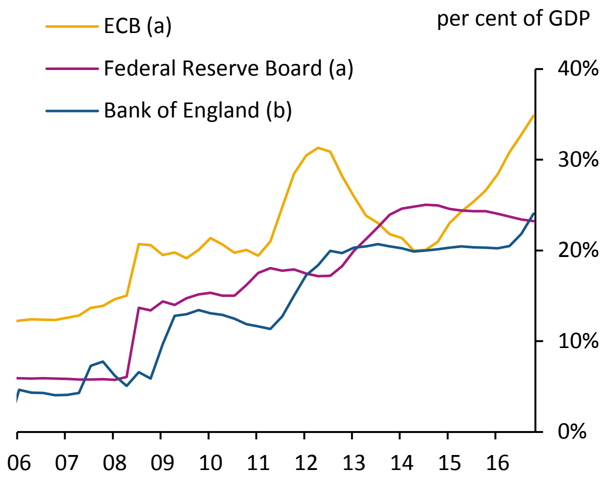
2.16 The FPC judges that, once those reserves are excluded, recalibrating leverage ratio capital requirements is an appropriate means of restoring the level of resilience on the remainder of firms' balance sheet.

2.17 The current UK leverage ratio framework requires: (i) a minimum requirement of 3% Tier 1; (ii) additional buffers for global systematically important firms that are 35% of their risk-

1 Article 429(4) of the CRR, as amended by the Commission Delegated Regulation (EU) 2015/62.

weighted global systemically important institution (G-SII) buffer requirements; and (iii) a countercyclical leverage ratio buffer set at 35% of the firm's risk-weighted countercyclical buffer (CCyB) rate – the UK CCyB rate is expected to be in the region of 1% when risks are neither subdued nor elevated.[1]

Chart 1: Central bank balance sheets as a percentage of nominal GDP



Sources: Datastream, Bloomberg, Bureau of Economic Analysis, Federal Reserve Board, Eurostat, ECB, ONS, Bank of England and Bank calculations.

(a) Total liabilities

(b) Includes reserves balances, short-term open market operations, notes in circulation and foreign currency public securities issued. Data as shown on the Bank's Weekly Report.

2.18 Based on balance sheets when the FPC made its Recommendation in 2016, the exclusion of central bank reserves was estimated to have reduced the Tier 1 capital needed to meet end-point UK leverage ratio requirements by around £13 billion in aggregate for the firms within scope. [2] That amount is equivalent to an aggregate increase of 25 basis points in leverage ratio capital requirements, on an exposure measure excluding central bank reserves. Capital needed to meet leverage ratio requirements prevailing in July 2016 was slightly lower, at around £11 billion, as G-SII buffers were being phased-in and the applicable UK CCyB rate was 0%.

2.19 The FPC is not proposing, in this consultation, any other changes to the current UK leverage ratio framework.

1 www.bankofengland.co.uk/financialstability/Documents/fpc/policystatement050416.pdf.
2 Based on July 2016 balance sheets and average central bank reserves held in the year up until the time of exclusion.

Alternative options considered

2.20 There are alternative approaches that could also offset the reduction in the amount of capital needed to meet leverage ratio requirements following the decision to exclude reserves from the exposure measure.

2.21 The FPC considered recommending that the PRA require firms to hold a fixed amount of capital as an add-on to minimum leverage ratio requirements, effectively adding a new component to the UK leverage ratio framework. The add-ons would sum to the estimated c.£13 billion of Tier 1 capital in aggregate and would be assigned to firms individually depending on their exposure measure after central bank reserves were excluded. Assuming the size and composition of balance sheets remained constant over time, the capital required both in aggregate and for each individual firm by this approach would have been the same as for the FPC's current proposal. When weighing the benefits of recalibrating in a simple way, as embodied in scaling up the minimum to 3.25%, against the potential costs associated with this more complex approach, the FPC decided against proposing this option.

2.22 Another option was to recalibrate leverage ratio capital requirements by introducing a new buffer, or by changing the current 35% scalar of the additional leverage ratio buffer and countercyclical leverage ratio buffer. However, the majority of capital needed to meet leverage ratio requirements is in the form of a minimum requirement. Offsetting the exclusion of central bank exposures through buffers would have been a loosening in capital requirements and the FPC did not intend for this to be the case.

Links with other policy initiatives

Minimum requirement for own funds and eligible liabilities

2.23 In November 2016, the Bank of England set out its policy on a minimum requirement for own funds and eligible liabilities (MREL).[1] The Bank 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.[2] There are interim requirements that apply to G-SIIs from 1 January 2019 and for all firms subject to MREL above capital requirements from 1 January 2020. The PRA also expects firms to hold an amount of common equity Tier 1, in addition to any own funds and liabilities counted towards MREL, that reflects their risk-weighted capital and leverage ratio buffers.[3]

2.24 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.

Stress testing

2.25 In March 2017, the Bank set out the key elements of the 2017 stress test.[4] This set out that the leverage ratio exposure measure and threshold against which banks will be assessed in the 2017 stress test will be updated, to reflect the outcomes of this consultation announced by the FPC and implemented by the PRA.

1 www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf.
2 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.
3 www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss1616.aspx.
4 www.bankofengland.co.uk/financialstability/Pages/fpc/stresstest.aspx.

Cost benefit analysis of the proposals

2.26 The FPC expects the exclusion of central bank reserves from the leverage exposure measure and recalibration of leverage ratio capital requirements to provide benefits to financial stability and economic growth, including support to productive investment.

2.27 The proposal to exclude central bank reserves mitigates a potential cost that the leverage ratio framework impairs the effective transmission of monetary policy. It also bolsters the financial sector's ability to cushion shocks to the financial system, by allowing firms to draw on central bank liquidity as necessary without becoming constrained or dissuaded by leverage ratio capital requirements.

2.28 The exclusion of central bank reserves from the exposure measure reduced the capital needed to meet leverage ratio requirements, with a 3% minimum requirement. The proposal to increase the minimum leverage ratio requirement to 3.25% on the redefined exposure measure is a means of offsetting the aggregate reduction in capital requirements that resulted from the exclusion of claims on central banks from the exposure measure. Consequently, it maintains the resilience delivered by the UK leverage ratio framework.

2.29 The policy therefore slightly decreases the public costs associated with leverage ratio capital requirements by removing the potential impairment to the effective transmission of monetary policy, without affecting its benefits as assessed in the FPC's 2014 Leverage Ratio Review.[1]

2.30 The proposal also retains the simple approach of the leverage ratio framework, ensuring it remains a transparent and credible guardrail against risk weight uncertainty.

2.31 Nevertheless, the FPC recognises that there may be some costs associated with the proposal.

2.32 First, central bank reserves vary as a proportion of assets across firms. For firms that held relatively low levels of central bank reserves in July 2016, the recalibrated minimum requirement might mean a small increase in the capital and MREL resources needed to meet the UK leverage capital requirements and MREL. However, this impact is dampened as overall capital requirements and MREL for most firms are constrained by the risk-weighted capital framework. The Committee therefore does not expect the proposed recalibration to affect its competition assessment, as set out in the July 2016 *Financial Stability Report*.[2]

2.33 Second, this recalibration increases the extra capital needed to meet leverage ratio requirements when firms expand their balance sheets in assets other than central bank reserves. This could add to any existing impact of leverage ratio capital requirements on firms' incentives to undertake low-risk weight, low-return activities, such as the provision of repo financing or client clearing of derivatives services. This effect might be more significant if firms are choosing to apply leverage ratio capital requirements to individual business lines. However, as the FPC restated in the July 2016 *Financial Stability Report*, the requirements are intended to apply at consolidated level and not to individual activities. Even so, any impact is likely to be small compared to the introduction of leverage ratio capital requirements.

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1 www.bankofengland.co.uk/financialstability/Pages/fpc/fscp.aspx. The FPC has also performed an assessment of the policy proposals in this CP and does not consider that the proposals give rise to equality and diversity implications.

2 www.bankofengland.co.uk/publications/Pages/fsr/2016/jul.aspx.

2.34 Finally, depending on how the size and composition of firms' balance sheets evolve over time, there are scenarios where the FPC proposal would lead to more capital being needed to meet revised leverage ratio requirements, than by one with a 3% minimum requirement on an exposure measure including central bank reserves. In particular, more capital would be needed to meet leverage ratio requirements, if holdings of central bank reserves declined while holdings of other assets grew.

2.35 Overall, the FPC judges these effects should not substantially affect the international competitiveness of London or the UK financial system.

2.36 The FPC will monitor the impact of these proposals over the medium to longer term.

2.37 Separate to these proposals, the FPC intends to carry out an in-depth review of its leverage ratio framework pending progress on an international leverage ratio standard. This will include considering expanding the scope to other PRA-regulated banks, building societies and investment firms, and when and how to apply requirements at individual entity level.

3 PRA CP11/17

3.1 The PRA proposes to implement the FPC's proposed Recommendation through three sets of changes to the Leverage Ratio framework, as set out in the PRA Rulebook and SS46/15.[1]

(i) Exclude claims on central banks from the definition of the total leverage exposure measure in the UK leverage ratio framework

3.2 The PRA proposes to exclude claims on a central bank which are matched by deposits in the same currency and of identical or longer maturity from the definition of the total leverage exposure measure used to set UK leverage ratio capital requirements. 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.

3.3 In August 2016, the PRA invited firms to apply for a temporary modification of the Leverage Ratio Part of the PRA Rulebook. This was in response to a Recommendation from the FPC to allow the exclusion of central bank reserves from the total exposure measure used to calculate UK leverage ratio capital requirements.[2] All firms subject to the UK leverage ratio have been granted this modification. With this proposal the PRA aims to align the UK leverage ratio framework with modifications already granted to firms.

3.4 Central bank reserves are a unique asset class because they are the ultimate settlement asset. If matched by liabilities in the same currency, they typically do not represent an exposure to risk, including the risk of currency redenomination. Therefore, there is no need to build resilience against holdings of reserves.

3.5 There is also a potential macroeconomic cost in including central bank reserves in the total exposure measure used to calculate UK leverage ratio capital requirements. In circumstances where firms' balance sheets increase because of an expansion in central bank balance sheets, regulatory leverage ratio capital requirements could effectively tighten. This could act as an unnecessary constraint on the implementation of any monetary policy action that leads to an increase in reserves. It could also affect the ability of the banking system to cushion shocks and to maintain the supply of credit to the real economy and support for market functioning.

(ii) Increase the minimum leverage ratio capital requirement from 3% to 3.25%

3.6 In line with the FPC's proposal, the PRA proposes to increase the minimum leverage ratio requirement from 3% to 3.25% of total exposures. As currently, firms will need to meet the increased requirement with Tier 1 capital, at least 75% of which must be in the form of common equity Tier 1.[3]

3.7 The PRA noted in its August 2016 statement on the leverage ratio that it welcomed the FPC's intent to recalibrate UK leverage ratio capital requirements to adjust for the impact of excluding central bank reserves from the exposure measure. The 25 basis points recalibration

1 UK leverage ratio: instructions for completing data items FSA083 and FSA084, December 2015, available at: www.bankofengland.co.uk/pra/Pages/publications/ss/2015/ss4615.aspx.

2 www.bankofengland.co.uk/pra/Documents/publications/reports/prastatement0816.pdf. On 27 January 2017 the PRA invited firms to apply to a variation of that modification to align leverage reporting and disclosure requirements with the new definition of the total exposure measure. Firms granted the modification were asked to report form modified FSA083 in lieu of FSA083.

3 Requirements on the quality of the Additional Tier 1 capital that can be used to meet the leverage ratio requirement will also be maintained.

offsets the estimated £13 billion reduction in Tier 1 capital needed to meet the end-point UK leverage ratio capital requirements, based on July 2016 balance sheets prior to the exclusion of central bank reserves from the total exposure measure.

3.8 The current UK leverage ratio framework requires: (i) a minimum requirement of 3% Tier 1; (ii) additional buffers for G-SIIs that are 35% of their risk-weighted G-SII buffer requirements; and (iii) a countercyclical leverage ratio buffer set at 35% of the firm's risk-weighted CCyB rate – the UK CCyB rate is expected to be in the region of 1% when risks are neither subdued nor elevated. When the FPC made its Recommendation in 2016, the exclusion of reserves is estimated to have reduced the Tier 1 capital needed to meet the end-point UK leverage ratio capital requirements by around £13 billion in aggregate for the firms within scope. Capital required to meet actual leverage ratio capital requirements at July 2016 was slightly lower, at £11 billion, as G-SII buffers were being phased-in and the applicable UK CCyB rate was 0%.

(iii) Amend UK leverage ratio reporting requirements

3.9 In January 2017, the PRA invited firms to apply for a variation of the temporary rule modification granted in August 2016 in relation to the exclusion of certain central bank claims from the total exposure measure.[1] The purpose of the variation was to align leverage ratio reporting and disclosure requirements with the new definition of the total exposure measure.

3.10 The PRA proposes to amend the UK leverage ratio reporting requirements included in SS46/15 so as to: (i) align them with the new definition of the total exposure measure, consistent with the January 2017 variation of the rule modification; and (ii) bring them in line with the proposal in this CP to increase the minimum leverage requirement from 3% to 3.25%. The PRA proposes that these reporting changes come into effect the same date as this CP's proposed rule changes are finalised, which is expected to be ahead of the 31 December 2017 reporting date.

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

3.12 Firms will have to report to the PRA, but not disclose publically, 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.

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

3.14 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.

1 www.bankofengland.co.uk/pra/Documents/authorisations/waiverscrr/modbyconvarlr.pdf.

The PRA's statutory obligations

3.15 Before making any rules, the Financial Services and Markets Act 2000 (FSMA)[1] requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with the PRA's duty to act in a way that advances its general objective,[2] insurance objective[3] (if applicable), and secondary competition objective;[4]
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;[5] and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.[6]

3.16 The PRA is also required by the Equality Act 2010[7] to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

3.17 The PRA should also have regard to aspects of the UK government's economic policy as recommended by HM Treasury.[8]

Cost benefit analysis

3.18 The costs and benefits of excluding central bank reserves from the total exposure measure and increasing the minimum leverage requirement to 3.25% have been assessed and outlined by the FPC, and set out in its consultation in Section 2. The PRA agrees with that assessment.

3.19 The proposal to amend the leverage ratio reporting and disclosure requirements should enhance market discipline and transparency. The revised modification offered to firms by the PRA in January 2017 implemented the new elements of the reporting and disclosure proposals in this CP.[9] As of 1 April 2017 all firms impacted by the proposal in this CP have implemented this modification. As firms in scope of this proposal are already compliant, the PRA does not expect they will have to incur any further implementation costs from this proposal going forward. The proposal will ensure firms continue to be compliant with these reporting and disclosure requirements.

Compatibility with the PRA's objectives

3.20 The leverage ratio framework enhances the effectiveness of capital regulation and guards against failing to capture risks effectively, which promotes the safety and soundness of institutions. The proposals in this CP ensure that the leverage ratio framework continues to do so effectively while not constraining firms from making use of central bank facilities.

1 Section 138J of FSMA.
2 Section 2B of FSMA.
3 Section 2C of FSMA.
4 Section 2H(1) of FSMA.
5 Sections 2H(2) and 3B of FSMA.
6 Section 138K of FSMA.
7 Section 149 of Equality Act.
8 www.gov.uk/government/uploads/system/uploads/attachment_data/file/597419/Prudential-Regulation-Committee-Spring-Budget-2017.pdf.
9 Modification by Consent to Leverage Ratio rule 1.2, Public Disclosure rule 1.1 and Reporting Leverage Ratio rule 1.2 is available at www.bankofengland.co.uk/pra/Pages/authorisations/waivers/waiversbyconsent.aspx.

3.21 The PRA has assessed whether the proposal in this CP facilitates effective competition. It is possible that the proposed increase in the minimum leverage ratio requirement to 3.25% of total exposures excluding central bank reserves may result in some firms facing marginally higher or lower nominal requirements than under a 3% minimum leverage ratio requirement including central bank reserves. However, the impact is dampened as capital requirements for most firms are constrained by the risk-weighted capital framework. The PRA expects all firms to have sufficient capital resources to meet the higher requirement.

Regulatory principles

3.22 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Two of the principles are of particular relevance:

- the desirability of sustainable economic growth; and
- the desirability to require the disclosure of information as a means of contributing to the advancement by each regulator of its objectives.

3.23 The PRA expects the exclusion of central bank reserves from the leverage exposure measure and recalibration of UK leverage ratio capital requirements to provide benefits to financial stability and economic growth without compromising resilience. The proposal to exclude central bank reserves mitigates a potential risk that the leverage ratio framework impairs the effective transmission of monetary policy. It also bolsters the financial sector's ability to cushion shocks to the financial system by drawing on central bank liquidity as necessary, without becoming constrained by leverage ratio capital requirements. At the same time, by recalibrating to offset the aggregate reduction in capital requirements that result from excluding central bank reserves from the exposure measure, the proposal does not compromise the resilience delivered by the UK leverage ratio framework.

3.24 The proposed amendments to firms' leverage ratio disclosure requirements contribute to the safety and soundness of institutions by enhancing market discipline.

Impact on mutuals

3.25 As set out above, it is possible that for some institutions the additional capital required to meet the proposed minimum leverage requirement of 3.25% is higher than the reduction in capital required that results from the proposed adjustment to the definition of the total exposures measure. In cases of firms that are leverage constrained, this may result in firms having to take actions to improve their leverage ratios. The PRA recognises that mutuals 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.

Equality and diversity

3.26 The PRA has performed an assessment of the policy proposals in this CP and does not consider that the proposals give rise to equality and diversity implications.

UK government's economic policy

3.27 HM Treasury has made recommendations to the Prudential Regulation Committee about aspects of the Government's economic policy to which the Committee should have regard when considering how to advance the objectives of the PRA and apply the regulatory principles as set out in FSMA. The aspects of the Government's economic policy most relevant to the proposals in this CP are:

(i) the competitiveness of UK financial system;

(ii) the access of companies to finance and investment; and

(iii) impact on economic growth.

3.28 The PRA does not expect these proposals to substantially affect the international competitiveness of London or the UK financial system.

3.29 The PRA considers that the exclusion of central bank reserves from the leverage exposure measure and recalibration of leverage ratio capital requirements should provide benefits to financial stability and economic growth, including support to productive investment.

Appendices

1	**Draft LEVERAGE RATIO AND REPORTING LEVERAGE RATIO (AMENDMENT) INSTRUMENT [2017]**
2	**Draft amendments to Supervisory Statement 46/15 ‘UK leverage ratio: instructions for completing data items FSA083 and FSA084’**
3	**Draft amendments to reporting template FSA083**
4	**Draft amendments to the reporting instructions for template FSA083**

Appendix 1: Draft LEVERAGE RATIO AND REPORTING LEVERAGE RATIO (AMENDMENT) INSTRUMENT [2017]

PRA RULEBOOK: CRR FIRMS: LEVERAGE RATIO AND REPORTING LEVERAGE RATIO (AMENDMENT) INSTRUMENT [2017]

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (The PRA's general rules); and
(2) section 137T (General supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: CRR Firms: Leverage Ratio and Reporting Leverage Ratio (Amendment) Instrument [2017]

D. The rules in the Parts of the PRA Rulebook listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Leverage ratio	A
Reporting Leverage ratio	B

Commencement

E. This instrument comes into force on [DATE].

Citation

F. This instrument may be cited as the PRA Rulebook: CRR Firms: Leverage Ratio and Reporting Leverage Ratio (Amendment) Instrument [2017].

By order of the Prudential Regulation Committee
[DATE]

Annex A

Amendments to the Leverage Ratio Part

In this Annex new text is underlined.

1 APPLICATION AND DEFINITIONS

…

1.2 In this Part, the following definitions shall apply:

…

central bank claim

means the following exposures of a *firm* to a *central bank*, provided these are denominated in the national currency of such *central bank*:

(1) banknotes and coins constituting legal currency in the jurisdiction of the *central bank*;

(2) reserves held by a *firm* at the *central bank*; and

(3) any assets representing debt claims on the *central bank* with a maturity of no longer than 3 months.

…

total exposure measure

has the meaning given by Article 429(4) of the CRR, as amended by the Commission Delegated Regulation (EU) 2015/62-, save that a *central bank claim* of a *firm* shall be netted off against a *deposit* accepted by the *firm*, provided that:

(1) the *central bank claim* and *deposit* are denominated in the same currency; and

(2) where applicable, the date of contractual maturity of the *central bank claim* is the same as, or is before, the date of contractual maturity of the *deposit*.

…

3 MINIMUM LEVERAGE RATIO

3.1 A *firm* must hold sufficient *Tier 1 capital* to maintain, at all times, a minimum *leverage ratio* of 3.25%.

…

Annex B

Amendments to the Reporting Leverage Ratio Part

In this Annex new text is underlined and deleted text is struck through.

…

3 REPORTING

3.1 Subject to *4.1*, a *firm* must complete the *data item* FSA083 using the template for the *data item* set out ~~*here*~~ *here*.

Term	Definition source
central bank	Article 4(1)(46) CRR

Appendix 2: Draft amendments to supervisory statement 46/15 'UK leverage ratio: instructions for completing data items FSA083 and FSA084'

In this Appendix new text is underlined and deleted text is struck through.

…

Completing data items 2

2.1 The instructions included in the links below form part of this supervisory statement. Italicised text in the instructions has the same meaning given in the Leverage Ratio and Reporting Leverage Ratio Part of the Rulebook, or in the PRA Rulebook Glossary.

- Instructions for completing FSA083 (Leverage Ratio Template):
  ~~www.bankofengland.co.uk/pra/Documents/crdiv/fsa083instructions.pdf~~
  [link to be inserted when policy is finalised and updated template published]

…

Appendix 3: Draft amendments to reporting template FSA083

Deleted text is shown as struck through, and insertions underlined.

FSA083 Leverage Ratio template

General Information

...

Leverage Ratio Calculation

		Column			
		Daily / Monthly Average over the reporting quarter	**End-Month 3 (CRR Reporting reference date)**	**Quarter Low**	**Quarter high**
Row	**Exposure Values**	**UK c010**	EU c010	**UK c020**	**UK c030**
...					
UK r291	(-) Claims on central banks excluded				
UK r292	(-) of which claims in sterling to the Bank of England				
UK r293	Total Leverage Ratio exposure excluding claims on central banks				

Supplementary Data

...					
Capital Surplus / (Shortfall)					
UK r040	Surplus (shortfall) CET1 to ~~2.25~~ 2.4375% minimum CET1 requirement				
UK r050	Surplus (Shortfall) Tier 1 to ~~3~~ 3.25% minimum Tier 1 requirement				
UK r060	Surplus (Shortfall) CET1 to ~~2.25~~ 2.4375% minimum CET1 plus buffers				

Appendix 4: Draft amendments to the instructions of reporting template FSA083

This CP proposes amendments where deleted text is shown as struck through, and insertions underlined.

Firms should complete this *data item* from 1 January 2017, with the first reporting reference date as at 3~~1 March 2017~~ <u>31 December 2017</u>.

General Information

This template consists of two sections:

- Leverage Ratio Calculation

This section is based on COREP Leverage Ratio Calculation (LRCalc) template with additional UK specific columns (UK c010, UK c020 and UK c030) introduced to report *average leverage ratio*, quarter low and quarter high *total exposure measures*.

- Supplementary Data

This section is designed to capture data that are relevant to the UK leverage ratio framework.

Firms should refer to LRCalc and its instructions for rows and columns with the prefix of 'EU'. Rows and columns created or modified to capture UK specific leverage ratio data are prefixed with 'UK'.

Data elements

Only the open, or "white" cells, are to be completed. Grey-shaded cells are not required. The *data elements* are referred to by row (r) or column (c).

Columns

- **UK c010: Daily / monthly average over the reporting quarter**

Firms to report daily or monthly average leverage ratio data according to the methodology specified in the UK leverage ratio framework.

- **EU c010: End-month 3 (CRR reporting reference date)**

Firms to report end-quarter leverage ratio data according to LRCalc template and instructions.

- **UK c020: Quarter low**

Firms to report the lowest daily total exposure measure over the reporting quarter.

- **UK c030: Quarter high**

Firms to report the highest daily total exposure measure over the reporting quarter.

Rows - Leverage Ratio Calculation

- **UK r290: Total Leverage Ratio exposure**

Firms to report total exposure measure.

- <u>**UK r291 (-) Claims on central banks excluded**</u>

<u>Firms to report the total amount of central bank claims that are excluded from the leverage ratio exposure measure.</u>

- <u>**UK r292 (-) of which claims in sterling to the Bank of England**</u>

<u>Firms to report the amount of claims in sterling to the Bank of England excluded from the UK leverage ratio exposure measure in accordance with the modification. The sterling amount will thus be included in UK r291, and then singled out in row UK r292.</u>

- <u>**UK r293 Total Leverage Ratio exposure excluding claims on central banks**</u>

Firms to report the total leverage ratio exposure excluding claims on central banks.

- **UK r310: Tier 1 capital**

Firms to report total Tier 1 capital.

- **UK r330: Leverage Ratio**

Firms to report the leverage ratio, expressed as a percentage of Tier 1 capital divided by total exposure measure.

Rows - Supplementary Data

- **UK r010: CET1 capital**

Firms to report total common equity Tier 1 capital that can be counted as Tier 1 capital.

- **UK r020: G-SII additional leverage ratio buffer rate (%)**

Firms that are subject to a requirement to do so to report the buffer rate expressed as a percentage of firms' G-SII additional leverage ratio buffer (G-SII ALRB) to total exposure measure.

- **UK r030: Countercyclical leverage ratio buffer rate (%)**

Firms to report the buffer rate expressed as a percentage of firms' countercyclical leverage ratio buffer to total exposure measure.

- **UK r040: Surplus / (shortfall) CET1 to ~~2.25~~ 2.4375% minimum CET1 requirement**

Firms to report surplus or shortfall of common equity Tier 1 capital to meet the ~~2.25~~ 2.4375% minimum common equity Tier 1 capital requirement. The ~~2.25~~ 2.4375% is calculated as 75% of the ~~3~~ 3.25% minimum leverage ratio requirement.

- **UK r050: Surplus / (Shortfall) Tier 1 to ~~3~~ 3.25% minimum Tier 1 requirement**

Firms to report surplus or shortfall of Tier 1 capital to meet the ~~3~~ 3.25% minimum leverage ratio requirement.

- **UK r060 Surplus / (Shortfall) CET1 to ~~2.25~~ 2.4375% minimum CET1 plus buffers**

Firms to report surplus or shortfall of common equity Tier 1 capital to meet the ~~2.25~~ 2.4375% minimum common equity Tier 1 capital requirement plus G-SII ALRB (if the firm is subject to a requirement to calculate its G-SII ALRB) and countercyclical leverage ratio buffer as applicable. The ~~2.25~~ 2.4375% is calculated as 75% of the ~~3~~ 3.25% minimum leverage ratio requirement.

Validations

Submitted data must conform to the following validation rules:

Validation number	Row	Column		Descriptions
1	UK r330	UK c010	=	UK r310 UK c010 / UK ~~r290~~ r293 UK c010
2	UK r330	EU c010	=	UK r310 EU c010 / UK r290 EU c010
3	UK r040	UK c010	=	UK r010 UK c010 – UK ~~r290~~ r293 UK c010 x ~~2.25~~ 2.4375%
4	UK r040	EU c010	=	UK r010 EU c010 – UK r290 EU c010 x ~~2.25~~ 2.4375%
5	UK r050	UK c010	=	UK r310 UK c010 – UK ~~r290~~ r293 UK c010 x 3.25%
6	UK r050	EU c010	=	UK r310 EU c010 – UK r290 EU c010 x 3.25%
7	UK r060	UK c010	=	UK r010 UK c010 – UK ~~r290~~ r293 UK c010 x (~~2.25~~ 2.4375% + UK r020 EU c010 + UK r030 EU c010)
8	UK r060	EU c010	=	UK r010 UK c010 – UK r290 EU c010 x (~~2.25~~ 2.4375% + UK r020 EU c010 + UK r030 EU c010)
9	UK r293	UK c010	=	UK r290 UKc010 – ABS(UKr291 UK C010)