Bail-in
Working Group

ICMA International Capital Market Association

Vicky Saporta
Bank of England
Threadneedle Street
London, EC2R 8AH

leveragereview@bankofengland.co.uk

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Dear Vicky,

Reference: The Financial Policy Committee's (FPC) review of the leverage ratio

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of over 400 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years.

The ICMA notes that the consultation paper sets out the FPC's analysis on the policy choices that would determine the role of a leverage ratio in the capital framework in the United Kingdom. It is understood that the responses to the consultation paper will inform the final review intended to be published by the FPC by November 2014.

The views expressed in this letter have been compiled in light of a range of inputs provided by the ICMA's member firms, including representations made from the buy-side perspective. As such, it represents a well informed considered, broadly-based view of the proposals from the relevant perspective and consequently, the ICMA respectfully requests that the FPC gives careful consideration to the points that this response raises.

RESPONSE:

Question 1 - Do you agree that the leverage ratio plays a complementary role to risk-weighted ratios and stress tests in assessing capital?

There needs to be clarity and simplicity in any leverage ratio imposed. If the risk-weighted ratio represents complexity and may mislead under certain circumstances, any leverage ratio needs to be simple to analyse and understand.

[1] For more information regarding the ICMA, please go to http://www.icmagroup.org/

Question 2 - Do you agree with the considerations regarding potential alternatives to the leverage ratio?
Debt investors are most concerned about transparency and adequate disclosure. However the regulator decides to measure and direct the financial institutions under its supervision, debt investors will require adequate disclosure to enable them to evaluate and measure the risk of potential impending failure and, therefore, bail-in.

Question 3 - Do you agree with the advantages and disadvantages of symmetry between the leverage ratio framework and the risk-weighted ratio? In particular as they relate to:
• including a minimum requirement and buffers analogous to the risk-weighted framework;
• establishing a leverage conservation buffer in proportion to the risk-weighted buffer;
• eligible capital;
• the level of application; and
• the scope of firms to which the framework is applied.
Debt investors are seeking a robust and simple system that works. Additional complexity in designing the leverage ratio is probably not helpful.

Question 4 - What are your views on the remaining design elements discussed in Chapter 3, in particular regarding the interaction between Pillar 2 and the leverage ratio, including for pension risks, and transitional arrangements, including coverage of only the large UK banks and building societies?
The key requirement for debt investors is simply that they are able to measure the risk of any regulatory intervention which would mark the potential for a bail-in of debt. Investors will be looking for as much disclosure as possible around the workings and levels of Pillar 2 and other risks. In the absence of such information, investors will not be in a position to analyse and therefore price the risk properly.

Question 5 - What are your views on the impact on different business models of a 'baseline' requirement in steady state?
There is a certain logic in applying a different leverage to lower risk banking models as there might be a perverse incentive to increase risks overall and dispose of good assets if the leverage ratio is overly restrictive. One size fits all has the merit of simplicity but may not fit the circumstances.

Question 6 - Do you agree with the considerations regarding a supplementary leverage ratio component for G-SIBs and RFBs?
No view.

Question 7 - Do you agree that it would be desirable to scale up the leverage ratio in proportion to the supplementary risk-weighted buffer for G-SIBs and RFBs, with a presumption of symmetry?
No view other than to urge simplicity and transparency.

Question 8 - Do you agree with the desirability of being able to vary the leverage ratio requirement in the same way as risk-weighted requirements can be varied through the countercyclical buffer?
As above. Debt investors will look to understand on what basis adjustments are made and how this will affect any given credit.

Question 9 - Do you agree that, as a guiding principle, the leverage ratio should vary in proportion to the risk-weighted countercyclical buffer?
As above.

<u>Question 10 - Do you have any views on the cost-benefit analysis considerations?</u>
Debt investors are currently struggling to price bank risk. There is insufficient information available about regulatory triggers, levels of capital, 'bail-inable' debt and the valuation methods that might be employed when assessing the need for, and quantum of, bail-in. Current markets are evidencing a significant compression of spreads across different instruments issued by banks, especially senior unsecured debt. There are many reasons for this. It is further acknowledged that the more subordinated, but higher yielding instruments such as Cocos are very hard to value and there is no agreed methodology employed by the market. Therefore, the impact of leverage and overall capital requirements on the pricing of bank debt is unclear given the many areas of uncertainty and the several distorting influences in the primary bond markets.

One aspect of the capital ratios and BRRD being considered by investors currently, is the way that setting these targets could increase market volatility and risk. Higher ratios and more conservative leverage generally should give investors comfort around the amount of risk they are running. However, as shocks are experienced by banks causing them to approach their assumed triggers or ratio thresholds, there is the concern that investors will look to cut their exposures as early as possible. This may potentially make nervous markets more nervous and volatile, increasing the risk of a debt market sell off becoming self-perpetuating.

CONCLUDING REMARKS:
The ICMA appreciates the valuable contribution made by the FPC's examination of the issues articulated in this response paper and would like to thank the FPC for its careful consideration of the points made herein. The ICMA remains at your disposal to discuss any of the above points.

Yours sincerely

Tim Skeet
Board Member – International Capital Market Association
Chairman – Bail-in Working Group