Insights

Proposed Revisions to Basel Leverage Ratio Framework

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Today, the Basel Committee on Banking Supervision (the "Committee") published a consultative document proposing revisions to its Basel III leverage ratio framework (the "Proposed Revisions"). Comments are due on the Proposed Revisions by July 6, 2016. Among other things, the Proposed Revisions provide that for purposes of calculating the denominator of the leverage ratio, off-balance sheet exposures of banks to securitization transactions are to be treated the same as such exposures are treated under the Basel Committee revisions to its securitization framework for risk-based capital ("Revised Securitization Framework"). Under this framework, banks are generally required to use a credit conversion factor ("CCF") of 100% for these exposures. If contractually provided for, however, servicers may advance cash to ensure an uninterrupted flow of payments to investors so long as the servicer is entitled to full reimbursement for any such cash advances and this reimbursement right is senior to other claims on cash flows from the underlying pool of exposures. At the national regulators' discretion, the undrawn portion of servicer cash advances or facilities that are unconditionally cancellable without prior notice may receive a CCF of 10%, which is the factor applicable to unconditionally cancellable commitments under the standardized approach for credit risk.

The Committee also indicated in the Proposed Revisions that it is working on further clarification regarding the treatment of traditional securitizations for the purposes of the leverage ratio. Under the Committee's revised securitization framework, where an originating bank meets operational requirements for the recognition of risk transfer, but does not meet the criteria for accounting de-recognition of securitized assets or has to include the special purpose vehicle within its scope of accounting consolidation, the originating bank is allowed to exclude the securitized assets from the calculation of its risk-weighted assets ("RWAs"). The Committee points out that it is possible to interpret such exclusion to mean either: (i) the securitized assets are excluded from the regulatory scope of consolidation and therefore should also be excluded from the Basel III leverage ratio exposure measure; or (ii) the securitized assets are included within the regulatory scope of consolidation, and therefore should be included in the Basel III leverage ratio exposure measure, but receive a 0% risk weight under the risk-based framework. The Committee points out that while the two interpretations produce the same results for risk-based capital purposes (i.e., no associated RWAs), their respective impacts on the Basel III leverage ratio exposure measure would be significantly different. The

Committee indicates in the Proposed Revisions that it will consider the outcome of its ongoing consultation on identification and measurement of step-in risk as well as reasons for inconsistency across jurisdictions in recognition of significant risk transfer to clarify the Basel III leverage ratio exposure measure treatment of traditional securitizations.

A copy of the consultative document may be found here.