SFJ

Securitization Forum of Japan

Hatsumeikaikan 3F 2-9-14 Toranomon,minato-ku,
Tokyo 105-0001 Japan
TEL: +81-3-3580-1156   FAX: +81-3-3580-1157
E-mail: info@sfj.gr.jp   URL: http://www.sfj.gr.jp/e/

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Comments on Revised Basel III leverage ratio framework and disclosure requirements

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I. Introduction

A. The Securitization Forum of Japan welcomes the Basel Committee's initiative and appreciates the opportunity to comment on the Revised Basel III leverage ratio framework and disclosure requirements ("the Consultative Document").

B. The consultative document this time is mainly focused on calculation method in terms of the Basel III leverage ratio ("the ratio") which does not necessarily pertain to securitization or its market practice directly. But since the ratio has been under discussion in the context of how we could address the liquidity risk experienced in the course of the financial crisis in 2007 and will be applicable to banks, one of major participants in Japanese securitization, we would like to present our comments regarding the proposals in the Consultative Document, mainly from the perspective of applicability and adaptability in the Japanese practice.

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II. Comments on the calculation and treatment of the Basel III leverage ratio

A. The Consultative Document requires that the ratio should be calculated on the average of the three month-end basis. In this regard, we are afraid that banks that do not monthly close their balance sheet would have a difficulty in calculating the ratio on monthly basis and thus the average of the three month-end ratio. At this stage therefore, it is appropriate to keep the ratio a reference for ongoing monitoring tool for the balance sheet leverage.

B. The Consultative Document defines the ratio as the Capital measure divided by the Exposure Measure, i.e., total asset, with its minimum requirement of 3%. Although this definition would address the risk associated with excessive on- and off-balance sheet leverage, we are afraid that the scope of asset type to be counted in Exposure Measure (the denominator) is so broadly defined that it would reduce sound availability of lending. In particular, because this definition would count all outstanding balance of loan, any loans based on actual demand on the part of say SMEs would lower this ratio, resulting in chilling effect in lending operation to such SMEs.

C. To avoid this downside in practice, it is advisable to consider the modification to define the ratio more risk-sensitive to excessive and improper leverage. For example, eliminating from the denominator items such as risk-free assets and other assets unnecessary to monitor in terms of excessive leverage would make this measure more effective.

D. We understand that the ratio is a useful index in that it could appropriately deter excessive leverage and its subsequent sudden deleveraging process in financial crisis. But we should also be aware of factors that would affect the deleveraging process. For example, increased correlation among underlying assets in a pool during the course of financial crisis would also bring about such process and exacerbate the banking system. Put differently, as long as diversification is fairly maintained in the asset pool, lower leverage ratio does not necessarily imply the adverse

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deleveraging potential. Another example is that higher leverage ratio does not necessarily mean safe if the bank is a systematically important bank.

E. Therefore, we think it is meaningful to consider the ratio and its minimum requirement of 3% in accordance with other factors associated with the potential deleveraging. And from this viewpoint, we think the ratio would fit more naturally into Pillar 2 than Pillar 1 treatment.

End of document.