

Response to feedback received

Leverage Ratio (LR)

Introduction

The Bank issued today the policy document on *Leverage Ratio* for banking institutions. This policy document incorporates the proposals from the Exposure Draft issued in August 2017, and has taken into account feedback during the consultation period.

The Bank received written responses from 56 respondents during the consultation period. Key comments received and the Bank's responses are set out in the following sections. Other comments and suggestions for clarification have been incorporated in the policy document or are addressed in the *Frequently Asked Questions*.

Bank Negara Malaysia
8 December 2017

1. Treatment of derivatives variation margin

- 1.1 The exposure draft proposed allowing variation margin to reduce the replacement cost component of derivatives exposures, subject to eligibility conditions, namely–
 - (a) the variation margin must be in the form of cash; and
 - (b) the variation margin must be calculated and exchanged on at least a daily basis.
- 1.2 Several respondents sought flexibility for the eligibility conditions, to include cases where non-cash variation margin is exchanged (e.g. liquid government securities), and where cash variation margin is calculated and exchanged on a less frequent basis (e.g. weekly basis).
- 1.3 The Bank has retained the proposed eligibility conditions to promote robust risk management in line with global best practices. The Bank's assessment further showed that the largest players in the Malaysian derivatives market deal largely in cash variation margin. Hence, the eligibility conditions are not expected to be disruptive to the Malaysian derivatives market based on current margining practices, or constrain banking institutions in any way.

2. Treatment of off-balance sheet (OBS) exposures

- 2.1 The exposure draft adopts a measurement approach for OBS exposures that is consistent with the measurement approach under the risk-based capital framework. Under this approach, the nominal amounts of OBS items are multiplied by credit conversion factors (CCFs) to obtain the OBS exposure amount. For the LR, the CCFs are subject to a 10% floor.
- 2.2 A number of respondents requested the Bank to remove the 10% CCF floor and adopt a 0% CCF for unconditionally cancellable commitments (UCCs), as is the treatment under the risk-based capital framework's standardised approach for credit risk.
- 2.3 The Bank is of the view that a 10% CCF floor for off-balance sheet items is appropriate. The LR acts as a backstop measure to the risk-based capital framework. The Bank also shares the concerns raised by international supervisory authorities that a 0% CCF does not appropriately reflect practical challenges faced by banking institutions when attempting to cancel UCCs (many factors contribute to such challenges including concerns over reputational risk). The Bank's supervisory observations suggest that, in practice, Malaysian banking institutions also face similar challenges in cancelling UCCs. The Bank's decision is also informed by the Basel Committee on Banking Supervision's (BCBS) revisions to the standardised approach for credit risk¹, to replace the 0% CCF treatment for UCCs with a higher CCF of 10%.

¹ <https://www.bis.org/bcbs/publ/d424.pdf>, December 2017.

3. Reporting requirements

- 3.1 The exposure draft proposed reporting timelines of 15 days after the month-end for entity and Skim Perbankan Islam (SPI) level reports. This reporting timeline is consistent with the requirements under the risk-based capital framework. Several respondents requested the Bank to extend the reporting deadline as some institutions may require enhancements to the reporting systems.

- 3.2 The Bank maintains the view that LR reporting timelines should be aligned with risk-based capital framework as both reports are complementary, to present a holistic picture of an institution's capital position. Taking into account system enhancements that banking institutions may need to make, the Bank accords additional time for banking institutions to submit their first LR reports. Banking institutions may submit the entity and SPI level LR reports for January and February 2018 together with March 2018 reports (i.e. to be submitted no later than 15 April 2018). This is incorporated in the final policy document (paragraph 16.3).