Leverage ratio: the case of public sector banks

EBA Workshop 'The application of proportionality measures in the EBA's regulatory work' 22 October 2013

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NWB BANK

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1. WHAT ARE PUBLIC SECTOR BANKS?

Business model of public sector banks

- **Set up and owned by member state's central government , regional government or local authorities**

- **Core philosophy: to support and foster undertakings in the public interest**

- **Low risk profile: explicit or implicit guarantee, same ratings as the government (mostly AAA)**

- **Activities: funding of public sector entities, support of SME's, funding of public private partnerships**

The European Association of Public Banks (EAPB)

- EAPB was founded on 4 May 2000 in response to an increasingly complex European legislation in the area of financial services and banking supervision
- The European Association of Public Banks (EAPB) represents the interests of 30 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions (combined balance sheet total of about € 3,500 billion; about 190,000 employees; i.e. covering a European market share of approximately 15%)

2. IMPACT OF LEVERAGE RATIO

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Impact of leverage ratio: NWB Bank as an example

Business model NWB Bank:

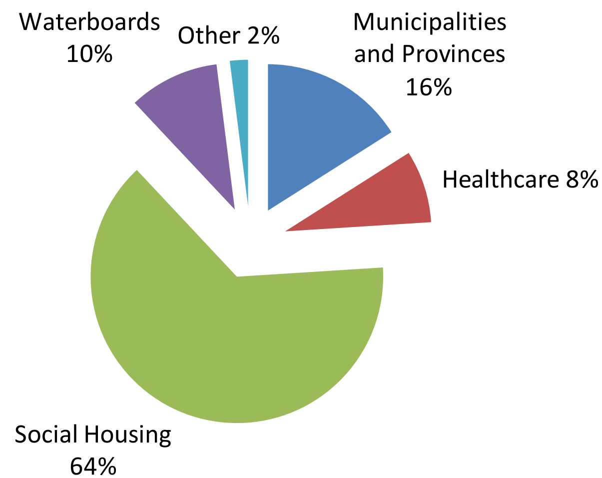
- **Financial services provider to the Dutch public sector**
- **Owned by the Dutch public sector:**
  - Central government 17%
  - Water control boards 81%
  - Provinces 2%
- **Water control boards are decentralised public authorities and have legal status similar to municipalities**
- **Low risk profile: very high solvency ratio and AAA ratings**
- **Funding on international money and capital markets on favourable terms**
- **High cost efficiency**

Loans Extended to High Quality Public Sector Borrowers

No significant changes in the composition of our total loan portfolio

- *Municipalities and Provinces:* *0% risk weighted*
- *Waterboards:* *0% risk weighted*
- *Social Housing:* *Guaranteed by WSW, 0% risk weighted*
- *Healthcare:* *Guaranteed by WFZ, 0% risk weighted*
- *Liquidity Portfolio:* *All government linked*

Implicit rating assets: AAA



Key Figures

	2012	2011	2010
Balance Sheet Total (EUR bln)	76.1	67.7	57.4
Net Profit (EUR mln)	40	75	91
Shareholders Equity (EUR mln)	1.226	1.188	1.135
Tier 1 ratio	111.0%	90.3%	99.9%
Cost / Interest Income ratio	13%	20%	12%
Capital ratio	1.6%	1.8%	2.0%

Leverage ratio becomes a binding constraint instead of a backstop:

- **Under present circumstances (low interest rate levels have increased balance sheet under IFRS with around 18%) a 3% LR requirement would mean NWB Bank has to double the size of equity and the risk weighted tier 1 ratio will increase to more than 200% (minimum: 8%)**
- **This would result in a strong decline in return on equity and provide an incentive to increase the risk profile of the bank**

3. ALTERNATIVES

To assure that leverage ratio becomes a backstop:

- **Take into account differences in business models by applying different suitable levels for the LR requirement or weighing the activities of banks (e.g. investment banking, corporate banking, retail banking/mortgages, public sector lending)**

- **Or exempt zero risk weighted assets**

- **Or apply a combination of (actual) tier 1 ratio and leverage ratio requirement (the higher the range of actual tier 1 ratio, the lower the LR requirement)**

4. CONCLUSION

CONCLUSION

- A one-dimensional application of the leverage ratio requirement will be very punitive for public sector banks because of their low risk profile and heavy bias towards low risk assets

- The leverage ratio should provide for a backstop and should not provoke low risk banks to increase their risk profile

- The principle of proportionality should be applied to the LR requirement by differentiating between business models

- Clarity on the LR requirement in due course is important because of market expectations and preparation time