



February 5, 2018

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision

Mr. Jurgen Janssens
Deputy Advisor Prudential Policy
National Bank of Belgium

Ms. Li Wenhong
Deputy Director General, Policy Research Department
China Banking Regulatory Commission

Re: Basel III: Treatment of extraordinary monetary policy operations in the Net Stable Funding Ratio

Dear Mr. Coen, Mr. Janssens and Ms. Li:

The Institute of International Finance (“IIF”) the Global Financial Markets Association (“GFMA”) and the International Swaps and Derivatives Association (“ISDA”) appreciate the opportunity to comment on the Basel Committee on Banking Supervision’s (“BCBS” or the “Committee”) proposal on changes to the treatment of extraordinary monetary policy operations in the Net Stable Funding Ratio (“NSFR”).¹ We have long endorsed the goals of the BCBS in creating the NSFR² to foster the better assessment of funding risks and promote funding stability.³ Now that the NSFR is being implemented globally, we continue to support its underlying policy objectives, including requiring banks to develop and maintain sustainable funding structures.

However, we have expressed to the BCBS and national authorities very significant continuing reservations regarding the NSFR and its impact on certain banking and capital markets activities. We believe that it is important that the NSFR – which is a new and generally untested regulatory standard – be subject to an appropriate monitoring and review period and should be carefully evaluated for its impact on activities and transactions where it would likely have excess effects or significant unintended consequences. As such, we are pleased the Committee has introduced a technical amendment to create greater flexibility in the treatment of extraordinary central bank liquidity-absorbing monetary policy operations to help ensure a balanced treatment of all central bank operations under the NSFR. Reduction in the Required Stable Funding (“RSF”) factors for central bank claims with maturity of more than 6 months is a welcome

¹ Basel Committee on Banking Supervision, *Basel III: Treatment of extraordinary monetary policy operations in the Net Stable Funding Ratio*, December 2017

² Basel Committee on Banking Supervision, *Basel III: The Net Stable Funding Ratio*; October 2014

³ IIF, GFMA, ISDA, TCH, ICMA Submission: *Consultative Document: Basel III, the Net Stable Funding Ratio*, April 11, 2014

development and one we believe will, as acknowledged by the Committee, assist in the ability or readiness of banks to participate in liquidity absorbing operations by central banks in the form of secured transactions with maturities longer than 6 months. At the same time, a review of RSF factors for private sector counterparties would also be warranted in this context to reduce asymmetrical incentives for lending to central banks over lending to private clients.

The technical amendment process outlined by the BCBS in this consultation is encouraging as it reflects the need for a dynamic approach to assessing Basel standards in a globally consistent manner, which is an essential issue for internationally active financial institutions. We strongly encourage the Committee, in consultation with the industry, to continue using the process of technical amendments to address issues that create potential for deleterious consequences for downstream lending to businesses and consumers.⁴ Liquidity standards are very new compared to the approaches to capital requirements. We believe it is important that they be adjusted where necessary to find methods that are more reflective of the liquidity and funding risks that the international liquidity rules are attempting to address.

In particular, significant issues under the NSFR continue to exist in relation to capital markets that would warrant further review and possible amendment. These include the severe restrictions it places on banks' ability to provide market services which facilitate client financing, investing and hedging. While banks and end-users may (or may not) be able and willing to absorb some incremental cost increases in capital markets services, the larger effect will be a contraction of financial markets activity and increased financial market volatility. If the cumulative effects of the NSFR are not manageable, banks will reduce their inventories, thus impairing market liquidity. Less liquid markets in turn will reduce issuers' access to investors through reduced participation, less efficiencies and increased costs.

The NSFR standard gives very little consideration to linked pass-through transactions that banks undertake for their clients and instead applies often high charges. These transactions involve little or no liquidity risk and facilitate client activity. One of these activities involves securities hedging customer derivative contracts, and others include client clearing, custody and short sale facilitations.

The assignment of long term stable funding requirements against these activities will result in their provision becoming economically unviable, and companies, pension funds and asset managers will not be able to manage their risks. This will result in increased economic volatility and impede business planning. We argue therefore that available and required stable funding factors for linked transactions should be symmetrical where relevant to avoid stable funding charges. Accordingly, there should be consideration of amendment to reflect a 0% RSF for securities hedging an 'initial margin' derivative and adjustments for securities hedging other derivatives. We also recommend the application of a 0% RSF for high quality securities to support market liquidity.

In relation to repos, the 10% and 15% RSF requirements on reverse transactions imposes a levy which will undoubtedly restrict the ability of banks to provide market liquidity for sovereign and other securities. Owing to the role of repo and collateral markets at the heart of the financial system, this would have negative implications for the management of risk and smooth functioning of financial markets. We therefore continue to recommend the adoption of a 0% RSF factor for reverse repo transactions which are collateralized by Level 1 HQLA.

⁴ We also acknowledge the utility of the Frequently Asked Question ("FAQ") process for clarification of implementation issues, however, as noted by the Committee, some issues cannot be resolved unambiguously without an amendment to the text of the standard itself. We would emphasize that technical amendments should not be limited to "minor" issues but should incorporate a process for review of all reforms to the standard where warranted.

In addition, the RSF calibrations for equity and exchange-traded funds (“ETF”) inventory should be revisited to properly reflect the funding requirements for these securities. The current RSF factors for equity inventory imply a more punitive funding requirement than historical market data suggests. In addition, ETFs are not classified as HQLA even if the underlying index is HQLA-eligible, which imposes an incremental funding requirement under the NSFR for firms that hold ETF inventory even when the ETF demonstrates comparable liquidity and funding characteristics to its underlying index. Reducing the RSF impact for certain classes of equity inventory may provide additional incentive for banks to provide much needed liquidity to equity markets during such periods. We recommend a review of these RSF calibrations and definition of HQLA-eligibility to ensure that firms raise the appropriate amount of funding to meet their funding needs.

Lastly, reflecting again a dynamic approach to review of the NSFR, we welcome the recent changes in relation to the treatment of derivatives liabilities and note that the adoption of a 5% factor would prevent uncertainty, avoid global fragmentation and contribute to a robust and efficient derivatives market.⁵ It is important, however, that there is recognition of all cash margin received, including when it does not fully extinguish the exposure and that margin in the form of Level 1 HQLA securities.

We look forward to further dialogue with you on this going forward. Should you have any questions, please do not hesitate to contact us or Matthew Ekberg at the IIF (mekberg@iif.com).

Very truly yours,



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⁵ Basel Committee on Banking Supervision, *Implementation of net stable funding ratio and treatment of derivative liabilities*, October 6, 2017