

Comments

On the Basel Committee Consultation Paper BCBS 271 "Basel III: the Net Stable Funding Ratio - Consultative Document"

Register of Interest Representatives

Identification number in the register: 52646912360-95

Contact:

Frank Bouillon

Telephone: +49 30 2021- 2213

Telefax: +49 30 2021- 192200

E-Mail: f.bouillon@bvr.de

Berlin, 14-04-10

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

Coordinator:

National Association of German
Cooperative Banks

Schellingstraße 4 | 10785 Berlin | Germany

Telephone: +49 30 2021-0

Telefax: +49 30 2021-1900

www.die-deutsche-kreditwirtschaft.de

Comments on the Basel Committee Consultation Paper BCBS 271 "Basel III: the Net Stable Funding Ratio - Consultative Document"

Dear Sir or Madam,

we appreciate the present opportunity to comment on the consultative document submitted by the Basel Committee "Basel III: The Net Stable Funding Ratio" (BCBS 271) in January 2014.

Please find our comments of a more general nature on the Basel consultative document below along with a number of comments on the reporting templates for the Basel III implementation monitoring and on the corresponding explanations already amended on the basis of the present consultative document. Many of implications triggered by the Basel Committee's amendment proposals can only be fully assessed in the context of the actual reporting data. In our view, this is a *conditio sine qua non* for a true and fair view of the impact which some of the proposed amendments will have both on banks and on the real economy.

I. General Comments

During its review of the NSFR rules, the Basel Committee considered the potential consequences which the NSFR introduction will have on the financial markets' function as well as on the overall economy; We explicitly welcome this approach. The pivotal importance of an adjustment of the NSFR is highlighted by the focus placed on the key issues under BCBS 271 No. 6, i.e. the impact on retail business activities, the treatment of short-term matched funding of assets and liabilities as well as an analysis of sub-one year buckets for both assets and liabilities.

The current calibration of the NSFR factors is based on this analysis. The BCBS holds the view that this reflects different assumptions concerning the stability of liabilities across two dimensions (BCBS 271 No. 12):

- Longer-term liabilities feature greater stability than short-term liabilities
- Deposits made by retail customers and deposits made by small business customers are more stable than wholesale funding deposits of the same maturity.

We furthermore welcome the change to the definition of the Net Stable Funding Ratio (NSFR) from a 1 year long stress test to a structural liquidity risk metrics. This complements the Liquidity Coverage Ratio (LCR) that is based on an extremely severe liquidity stress scenario, with a more sustainable business-as-usual approach in the long term.

The Available Stable Funding (AFS) and Required Stable Funding (RSF) factors should reflect this sustainable business-as-usual approach that is consistent with the role of the banking industry in the liquidity maturity transformation. Indeed, the liquidity maturity transformation is needed for the economy since there is a structural discrepancy between liquidity providers and liquidity takers. Hence, the NSFR should reflect the extent of the acceptable sustainable liquidity maturity transformation, and the sources of this maturity transformation.

Furthermore, we suggest adopting a waiver for transactions which form part of a bank's so-called reduction portfolio. For the purposes of calculating the NSFR, weighting factors shall be applied which are subject to certain implicit prolongation assumptions. For transactions in reduction portfolios, these weighting factors are not fit for purpose. Our caveat is owed to the fact that, at this juncture, a phase-

Comments on the Basel Committee Consultation Paper BCBS 271 "Basel III: the Net Stable Funding Ratio - Consultative Document"

out is explicitly desired, or, moreover, is being requested by an external third party. Based on the above, we recommend a waiver (subject to supervisory approval) for transactions in phase-out portfolios, i.e. these transactions should be posted separately and they should not be factored into the weighting factor during the NSFR's calculation.

II. Specific Comments

1. Definition of the Available Stable Funding (ASF)

According to point 17, when determining the maturity of an equity or liability instrument, investors are assumed to redeem a call option at the earliest possible date. For funding with options exercisable at the bank's discretion, banks should assume that they will be exercised at the earliest possible date unless the bank can demonstrate to its supervisor's satisfaction that the bank would not exercise this option under any circumstances. This sentence should be deleted due to the fact that the right to exercise the option is incumbent upon the issuing bank and given that the latter would not call in these funding resources during a stress scenario – after all, this is precisely the rationale underlying the NSFR's inception. Hence, there should be a 100% ASF factor, namely to be applied upon the maturity date.

2. Reverse Repos

The current NSFR rules for reverse repos are currently not symmetrical with the ASF from repos and neglect the funding potential from received HQLA collateral from reverse repos. It is impossible to migrate excess NSFR between banks by reverse repos on HQLA collateral, but reverse repo transactions even lead in total to a loss of NSFR for both banks.

In previous versions of the NSFR, repo transactions with financial institutions received a symmetrical treatment between assets and liabilities. Secured lending and secured funding under one year had both a 0% weight. Transactions with a maturity > 1 year had a 100% weight. It lacked taking into account the liquidity of the underlying collateral, and only considered the maturity of the repo transaction. For reverse repos > 1 year, it resulted in a worse treatment of those assets if compared to LCR.

The ratio did not differentiate between banks and other financial institutions, and was symmetrical in the treatment of repos and reverse repos.

The new NSFR has not solved the issue of not taking into account the underlying collateral, and adds new inconsistencies:

- It differentiates banks from other financial institutions when looking at the counterparty
- Although it gives a symmetrical treatment to repos and reverse repos for transactions with banks, other financial institutions receive an asymmetrical treatment in the < 6 month bucket: secured lending to other financial institutions require 50% stable funding, while secured funding < 6 months does not provide any ASF.

Comments on the Basel Committee Consultation Paper BCBS 271 "Basel III: the Net Stable Funding Ratio - Consultative Document"

This asymmetrical treatment will deteriorate the repo markets, and especially penalize non-banking financial institutions as a counterparty for the transactions.

While BCBS 271 reflects correctly the encumbrance of securities due to the repo business, it ignores the re-usability of the received collateral from reverse repos.

This asymmetrical treatment of repos and reverse repos punishes the repo business above 6 months with any counterparty (banks and non banks). It hinders the transfer of secured funding between banks as well as the secured financing of the real economy. Finally, the volume of secured funding above 6 month will decrease significantly and the price will increase without any economical reason.

3. Loans maturing < 6 months (Par. 32 e)

All unencumbered loans maturing < 1 year (excluding those to banks) require 50% stable funding. On the other hand, wholesale funding is only considered as ASF if it has a maturity > 6 months. This implies that loans maturing < 6 months have to be prefunded at 50% with funding maturing > 6 months. Thus prefunding means negative maturity transformation.

The required pre-funding > 6 months for (the rollover of) corporates, mortgages and other retail loans maturing < 6 months seems to be justified to allow future lending. By prefunding the rollover of loans maturing within 6 months, future deleverage is apparently avoided.

The unintended consequence is nevertheless current deleverage: the funding required for loans maturing up to 1 year drains funding for present lending. Therefore lending today is impaired by the possibility of lending tomorrow.

Moreover, the liquidity hold for the prefunding can never be actually used in the future. As loans mature in the coming 6 months, loans that were beyond the 6 months horizon will fall into this bucket. Their matched funding (< 6 months) will not be considered stable anymore, so that they will require new stable funding. Thus the previous pre-funding cannot be used for new lending, but has to remain to prefund the future rollover of the loans that have fallen in the horizon.

4. Treatment of Gold and Precious Metals

The consultative document of the NSFR 2014 on page 11 under the heading "Additional granularity and lower RSF factors for certain other non-HQLA" reads:

Certain assets with risk weights greater than 35% under the Basel II Standardised Approach, including unencumbered performing loans with residual maturity of one year or greater, unencumbered non-HQLA securities not in default, physical traded commodities and exchange-traded equities have been moved to a category requiring an 85% RSF factor from a category requiring a 100% RSF factor in the 2010 NSFR

This is true for all asset classes mentioned in his paragraph other than physical traded commodities including gold. Indeed, the 2010 NSFR proposal by the Basel Committee applied a RSF factor of 50% to

Comments on the Basel Committee Consultation Paper BCBS 271 "Basel III: the Net Stable Funding Ratio - Consultative Document"

gold which would mean, that the new proposal is a worsening of the initial proposal, where the phrasing in the 2014 proposal suggests, that it rather should be an easing of the funding requirement.

Can the Basel Committee confirm its view on the treatment of gold (and other precious metals)? We believe that the treatment in NSFR 2014 should not lead to a worsening of treatment compared to the NSFR 2010 proposal unless there is a valid reason to do so.

5. Treatment of equities

Whilst this is a slight improvement over the current regime, the GBIC still has difficulties in comprehending the rationale for assigning an 85% RSF factor to exchange-traded equities and a 100% RSF factor to non-exchange-traded equities. In the LCR, certain equities are eligible for recognition as Level 2 assets; the fluctuations in value are covered by a 50% haircut. Equity markets regularly remain highly liquid; whilst not limited to, this became particularly evident during the crisis which is why we have difficulties in comprehending the rationale for the putative lack of liquidity or low liquidity for equities.

6. Treatment of derivatives

Even if the regulation has still not been definitively finalised, from a NSFR perspective we want to point out some remarks on the treatments of derivatives positions and related cash collateral paid/received as initial and/or variation margins.

Considering, for example, a derivative margining set that reports a negative mark-to-market (MTM) backed by cash collateral (given to a specific counterparty). In financial statements this negative MTM is reported on the liabilities side, while on the contrary the cash collateral is reported as a loan on the asset side. It is not clear then where should the "cash collateral given" be allocated in the NSFR. If it would be reported between "other assets", it should be assigned an ASF factor equal to 100%, and then be all funded by "stable funding", even if the contracts included in the margining set had maturities potentially lower than one year (e.g. Overnight Index Swap). On the other hand, the same problem could occur for a derivative margining set with positive MTM back by "cash collateral received", then weighted by a RSF factor of 0%.

It is not clear, in our opinion, if the current approach has yet to be better defined with regard to the treatment of cash collateral paid/received as initial and/or variation margins, or whether these cash positions should be funded/invested on a long-term horizon. In the latter case, it should be noted that the market standards (based on the NPV/OIS discounting) consider these items as very short term positions consistently with the remuneration paid by the CCP.

According to point 22 c), also the treatment of derivatives shall be defined in the NSFR. According to the QIS template instructions, derivatives shall be considered in the NSFR on the basis of the supervisory netting rules. There should be a clarification that the liquidity impact of derivatives has to be reflected in the NSFR; thus, at least the collateral obtained and granted as well as netting of derivative and collateral positions caused by client clearing can be integrated into the derivatives position. As an alternative solution for client clearing positions where the bank acts as a clearing member it would also be possible to report these positions separately with distinct ASF and RSF factors of 0%

**Comments on the Basel Committee Consultation Paper BCBS 271
"Basel III: the Net Stable Funding Ratio - Consultative Document"**

7. Secured funding transactions (ASF Category)

The past liquidity crisis has demonstrated that, first and foremost, the provision of liquidity between banks depends on mutual confidence. At this juncture, a lack of confidence is not necessarily displayed towards the direct counterparty. Instead, it manifested itself primarily as a general lack of confidence in the market.

In light of the above, the ratio of secured funding transactions through repo / lending business became an important tool for the diversification of liquidity management. It created a major gain in confidence in the overall market. Above all, also regulators essentially view this trend towards secured transactions in a positive light; it has made a contribution towards enhancing and diversifying the money market activities of many banks. This achievement should not be eroded by the NSFR but, instead the NSFR ought to reflect this reality. Hence, in the ASF category "Secured borrowing and liabilities of which are from: other legal entities (including financial corporates and financial institutions)" should allow recognition of the funds thus obtained with a 50% factor also in the maturity bucket of up to six months (see the actual NSFR monitoring template).

Since the funding transactions are backed by very good collateral, there are no reasons against a prolongation of funding operations in this maturity bucket featuring shorter maturities. At this juncture, too, the assumption of an existing "deposit base" is thus justified. As a result, in a risk sensitive manner and to an appropriate degree, also a certain amount of these more short-term money market transactions will be available for maturity time transformation. After all, due to the cover, it is no longer just the trust in the counterparty which is instrumental in market participants' decision to provide each other with liquidity. Instead, this decision depends first and foremost on the confidence in the collateral provided.

However, as an alternative to the entire ASF category "Secured borrowing and liabilities of which are from:...", we would like to suggest an approach which would further enhance the consistency with the LCR requirements which is similarly in line with the Committee's intents and purposes:

Except for central banks, in the LCR, the prolongation assumptions for secured funding transactions shall not depend on the counterparty. Instead, they are predicated on the quality of the collateral (BCBS 238 No. 115: Level 1 collateral -> Outflow rate 0%, Level2a -> 15% and Level 2b -> 50% for all other -> 100%). If applied to the NSFR by way of analogy, this would mean that here, too, the decisive factor would not consist in the counterparty but in the collateral. As an alternative to the generic 50% recognition of short-term secured funding transactions suggested by us, this would even warrant the assumption of a stable source of funding to the amount of 100%, 85%, 50% or 0% in the NSFR – thus mirroring the LCR outflow factors - regardless of the counterparties or maturities.

Conclusion

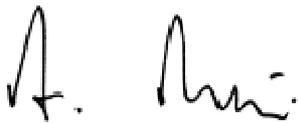
The implications of the amendments to the ASF and RSF factors which have been proposed simultaneously will inevitably also have an impact on the real economy. This is particularly true given that even short-term secured funding transactions with central banks will not be eligible for the purposes of calculating the NSFR. As regards maturities in the sub-one year bucket, the current proposals would largely prevent banks from ensuring a certain degree of maturity time transformation e.g. between retail deposits and advance lending on goods to small businesses - this failure would exclusively be owed to the introduction of the new supervisory measure. Hence, this is utterly counterproductive with regard to Basel Committee's initial intents and purposes: Transactions with retail customers and small business clients would be obstructed or would see an increase in costs.

**Comments on the Basel Committee Consultation Paper BCBS 271
"Basel III: the Net Stable Funding Ratio - Consultative Document"**

Hence, in light of the above caveats, we should like to suggest reconsidering the amendments tabled by the Basel Committee. Any erosion of stable liquidity networks with a tested and tried track record would be irresponsible; the same applies to jeopardising the funding structure of Germany's small business community.

By virtue of its proposed amendments, the Basel Committee seeks to mitigate the impact of the NSFR on retail and small business client transactions. We strongly welcome the fact that the BCBS achieves this goal by introducing higher ASF factors in these categories. This preferable effect may not be counteracted by other amendments.

Yours sincerely,
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks



Dr. Andreas Martin

i. V.



Jens Hielscher