



April 16, 2010

Secretariat of the Basel Committee on Banking Supervision  
Bank for International Settlements  
CH-4002, Basel  
Switzerland

Re: Consultative Documents—International Framework for Liquidity Risk Measurement, Standards and Monitoring; and—Strengthening the Resilience of the Banking Sector

Dear Ladies and Gentlemen:

The American Securitization Forum (the “ASF”)<sup>1</sup> appreciates the opportunity to provide these comments to the Basel Committee on Banking Supervision (the “Basel Committee”) on Consultative Document—International Framework for Liquidity Risk Measurement, Standards and Monitoring (the “Liquidity Risk Consultative Document”) and Consultative Document—Strengthening the Resilience of the Banking Sector (the “Banking Sector Consultative Document”) and, together with the Liquidity Risk Consultative Document, the “Consultative Documents”), each released on December 17, 2009. The Liquidity Risk Consultative Document sets forth proposals (the “Liquidity Risk Proposals”) to improve measures to manage and monitor liquidity risks, while the Banking Sector Consultative Document discusses proposals (the “Banking Sector Proposals”) and, together with the Liquidity Risk Proposals, the “Proposals”) to strengthen global capital and liquidity regulations and promote a more resilient banking sector.

Our comments principally focus on those elements of the Proposals that would directly or indirectly impact the short-term global capital markets, much of which is currently funded through the issuance of highly rated short-term securitized instruments and corporate securities that benefit from unfunded liquidity commitments provided by banks. These short-term markets play an essential role in the financial system and the global economy and provide many benefits, including efficiency of financing, incremental credit creation, credit cost reduction, liquidity creation and risk transfer.

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<sup>1</sup> The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 350 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. The ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to [www.americansecuritization.com](http://www.americansecuritization.com). For a brief description of the role and importance of securitization to the financial system and the U.S. economy, please see Exhibit A hereto.

We understand and appreciate the Basel Committee's focus in the Consultative Documents on bank liquidity management. The credit crunch has highlighted the importance to all operating businesses of careful, conservative liquidity management. In particular, liquidity is the "lifeblood" of the banking sector. It is therefore entirely appropriate for regulators to require banks to observe liquidity management guidelines that will reduce liquidity risk on both an institution-specific and systemic basis should another market downturn occur. At the same time, because of the very centrality of liquidity management to bank operations, we think that any changes to the regulatory framework should be carefully calibrated and should be phased in over time.

We have concerns with the Proposals and the potentially destabilizing effects that may flow from them. We also have thoughts and some specific suggestions regarding the Proposals, and we have set them forth herein with hopes they may be helpful. Thematically, we have the following concerns:

**Process:**

- Given the scale and wholesale changes introduced in the Proposals, the response timeline and implementation timeframe is far too compressed, giving rise to a very real possibility of significant unintended consequences.
- The information requested to be provided in connection with the Proposals is based on best efforts data and reporting templates that do not sufficiently consider the interconnectedness of the Proposals. This approach will substantively diminish the utility of the results of such information gathering and will materially throw into question any calibration exercise that relies on the results as an input.
- Several of the proposed frameworks presented in the Proposals are materially underdeveloped and incomplete (e.g., pro-cyclicality), which makes it virtually impossible for us or others to comment with a high degree of accuracy on the pro forma effects of the Proposals.
- We believe that implementation of the Proposals by different national bank regulators will likely be materially different—particularly given the sweeping nature of the proposed changes and the different considerations local regulators will face in considering the adoption of these proposed changes (including the effects on the local banking sectors and the local economies). The Proposals are so sweeping and in many regions transformative that we question the amount of consideration that has been given to the regional differences in banking activities and the international competitive advantages/disadvantages that could flow from these changes.
- The role of central Banks needs to be more fully considered and integrated into the Proposals to better balance the stated goals of reducing systemic risk, adjusting the micro- and macro-prudential risk framework and the economic goals and objectives of the global economies.

### **Calibration:**

- The Consultative Documents present an extremely comprehensive reform framework, the scope and effect of which are much greater than Basel II, which was implemented over an approximate ten-year period. The global financial markets are also simultaneously becoming subject to other significant new national and global regulatory, accounting and risk capital changes, all of which will ultimately affect these markets in fundamental ways. Anticipating the intended and unintended consequences of an immediate implementation of the Proposals is a task beyond anyone's reasonable capability.
- The current framework of the Proposals does not provide for reflection on the effects of the Proposals or an ability to adjust parameters if implementation of the Proposals does in fact have material unintended consequences. Implementation without proper calibration and without safety valves would be unwise. We think that the stated goals of the Basel Committee in presenting the Proposals could (and would) be better met through a policy statement (similar to the approach recently taken by the U.S. bank regulators through their release of the "Interagency Policy Statement on Funding and Liquidity Risk Management") that individual national bank regulators could implement through the in-place architecture of Pillar 2 in Basel II.
- When the cumulative effects of the Proposals are estimated, the substantial required cost and incremental cost attributable to traditional banking lines (e.g., corporate and investment grade lending) that benefit individuals, corporates and municipalities appear to us to be out of line with the Basel Committee's stated goals and crisis experience. We think that implementation of the Proposals in their current form would have a very negative effect on the availability and cost of credit throughout the global economies.
- Economic and regulatory policies such as the Proposals, which in essence require banks to cash collateralize virtually all of their potential liquidity exposure (even to the extent that such exposure may appear only if the bank suffers a sudden, extreme downgrade of its credit rating) and so self-insure themselves 100%, with zero tolerance for loss or even *de minimus* liquidity mismatch, are too conservative and run the risk of substantive economic disruptions.
- The Proposals would meaningfully and negatively impact very beneficial traditional, client-focused asset-backed commercial paper ("ABCP") conduit financing activities to the detriment of corporates that require working capital and competitive sources of financing for their core operations and small businesses and individuals who ultimately benefit from these financing activities. Traditional, client-focused ABCP conduits have fared well throughout the global liquidity crisis on a relative and absolute basis (i.e., no realized losses, draw experience within management planning and added diversification to bank liquidity profiles).

### **Focus and Potential Unintended Consequences:**

- The Proposals have a focus on "what went wrong" and attempt to address these items through capital and other requirements. This focus, however, fails to consider initiatives that worked well—such as central bank initiatives to expand the types of collateral that could be financed. We believe that central banks should endeavor to have consistent

programs in place to broaden the types of collateral that may be financed during periods of global liquidity tightening—this approach would mitigate systemic risk and alleviate the risk of “runs” on banks.

- Many products were subject to contagion during the global liquidity crisis and were meaningfully, but needlessly, devalued. This does not necessarily make them unsuitable products, but the Proposals treat them as such. There is a real risk that implementation of the Proposals in their current form will in fact permanently impair the ability of banks to employ these products in the global capital markets, to the detriment of banks and their customers and the global economies. These good and fundamental banking activities will likely move to a new shadow banking system and thereby introduce a different systemic profile that is not subject to regulatory oversight.
- The Proposals promote greater homogeneity and concentration of risk and liquidity management practices among large global banks. In a future crisis, these banks will all be similarly situated and will be compelled to behave the same way, which could create greater systemic risk and a magnified crisis in times of stress. The Basel Committee needs to promote greater diversification (not concentration) of risk and liquidity management practices as a means to reduce systemic risk.
- We have real concerns regarding banks’ ability to procure the collateral needed to comply with the “liquidity coverage ratio” (“LCR”), particularly in times of stress. The Proposals may make it easier for unregulated institutions to capitalize and profit from banks’ global needs to acquire vast quantities of narrowly-defined “highly liquid assets” when signs of stress hit the financial markets.
- The Proposals will (i) greatly increase banks’ needs to obtain permanent and long-term financing and (ii) virtually eliminate banks’ ability to obtain financing in the short-term markets. The cost of banks financing their acquisition of high quality liquid assets should be expected to be substantially higher than the yield on such high quality liquid assets. This negative carry will depress bank earnings or increase the charges and interest rates charged by banks to borrowers, or both, and so will adversely affect banks (and their shareholders and bank customers). Banks will also become more dependent on unregulated institutions to continually provide banks with financing and capital—particularly during crises.
- The “one size fits all” approach of the Proposals runs the risk of in fact changing the behavior of borrowers and lenders in ways that are difficult to foresee, but which may be troubling from a regulatory and practical perspective—for example, to the extent that the Proposals treat deposits as one of the few forms of “acceptable” long-term liquidity, is it possible that banks will chase such deposits to the degree that they will in fact become less stable?

### **The Consultative Documents**

Although we understand and appreciate the Basel Committee’s goals of the Proposals, we are particularly concerned that immediate adoption of the “Liquidity Coverage Ratio” test (the “LCR Test”) proposed in the Liquidity Risk Consultative Document could have a catastrophic effect on the short-term global capital markets. This proposal—by requiring banks at all times to hold a

stock of high quality liquid assets that equal or exceed their “net cash outflow” (calculated over a 30-day timeframe)—will significantly reduce (i) the amount of short-term funding that banks are able to provide to the credit markets and (ii) the amount of unfunded liquidity “backstop” facilities that banks may economically provide to corporations and other bank customers (which will in turn significantly reduce these customers’ ability to raise short-term funds at low interest rates). There will be a corresponding negative impact on the amount of high quality short-term debt instruments available for purchase by money market funds.

At a time when economic activity worldwide remains depressed in part because of the inability or unwillingness of banks to provide customer financing, regulators should be careful not to adopt new regulatory requirements that will further depress bank lending activity unless the need for and expected benefits of the new requirements are clearly demonstrated. It appears to us that there is a need for substantial (i) further consideration of these issues and (ii) revision of the technical elements of the Proposals (as described in greater detail below and in Exhibit B hereto). If the Basel Committee does decide to adopt some elements of the LCR, we believe that a measured and very gradual adoption of any such new liquidity regulations will enable regulators to properly assess the extent to which banks should be required to achieve “stand alone” liquidity sufficiency as defined by the LCR or any similar test.

As described below, it also appears to us that the implementation of the Proposals in their current form would result in banks being required to maintain capital and high quality liquid assets at levels that are much greater than any foreseeable level at which such banks may be required to provide funding to counterparties. The approach mandated by the Proposals, in conjunction with existing bank liquidity management practices and other Basel requirements that are expected to be adopted in the near future, will result in banks being required to hold permanent capital and high quality assets in quantities that will in the aggregate greatly exceed such banks’ “net cash outflows.”

The short-term global capital markets enable banks, corporates and their customers to raise funds at the lowest possible rates, and so enable these entities to offer low-interest rate financing to small businesses and individual consumers. These markets also permit state and other governmental entities to obtain low cost financing from a broad range of money market investors, including money market funds. The efficient functioning of these markets provides immense benefits to businesses, governments and investors throughout the globe. Many of the short-term debt products offered by issuers in the global capital markets are dependent on the ability of such issuers to obtain backstop liquidity facilities from banks. The provision of these types of backstop facilities therefore provides substantial benefits to these short-term capital markets participants. In fact, it would not be possible for most issuers to establish such low cost, short-term financing platforms without the presence of such bank liquidity backstop facilities.

For purposes of the LCR it is important to quantify the level of commitments that the LCR is trying to capture. A partial list of bank funding contingencies that could become payable over any prospective 30 day horizon would include the following:

- Bank-issued commercial paper (with initial or remaining maturities of 30 days or less)
- Bank-issued CDs (with initial or remaining maturities of 30 days or less)

- Bank long-term debt and consolidated bank-sponsored securitizations coming due within such 30 day window
- Other Bank short-term issued debt (with initial or remaining maturities of 30 days or less)
- Bank standby letters of credit
- Bank liquidity commitments for corporate client commercial paper issuers
- ABCP (with initial or remaining maturities of 30 days or less) issued by bank-sponsored commercial paper conduits.
- Bank revolver lines subject to same or next day draws
- Bank repo counterparty obligations (possibly netted for government collateral)
- Short-term tax-exempt instruments issued through bank-sponsored financing platforms that re-finance longer-term tax-exempt U.S. state or municipal obligations
- Bank ISDA obligations—FX, Interest, CDS, etc. (i) drawable amounts over a 30 day horizon or (ii) that are required to be collateralized if the Bank suffers a “three notch” credit rating downgrade

We think that the aggregate principal balance of such liquidity commitments provided by banks globally is the U.S. dollar equivalent of at least several trillion U.S. dollars. The LCR Test would require banks to hold high quality liquid assets against the entire commitment amount of these types of facilities (minus cumulative expected cash inflows), on the basis that the entire commitment amount of such facilities may be drawn on any given day (and so such commitments constitute “cash outflows” in the full amount of such commitments). We believe that this required amount of collateralization with high quality liquid assets is much too high and, indeed, that the LCR Test is fundamentally flawed insofar as it fails to discount the aggregate amount of potential cash outflows by the probability that all, or even a substantial portion, of the aggregate amount will actually be drawn in any 30 day period (even under stressed conditions).

In addition, bank efforts to satisfy the LCR requirement would by themselves create serious, perhaps non-solvable problems in the global capital markets. For instance, it would not seem possible for banks to acquire this volume of governmental securities—clearly many governments around the world are currently looking to raise funds through the issuance of national debt instruments, but it is unclear whether such governments collectively have the capacity to issue an additional amount of debt in a quantity anywhere near this level.<sup>2</sup> The level of additional bank deposits and bank debt and equity needed in order for banks to acquire this debt would be prohibitive and it would likely be impossible for banks to raise funds needed to acquire such government securities. Even if such securities issuances were possible, we do not think it is

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<sup>2</sup> The Basel Committee indicates in the Banking Sector Consultative Document that it may decide to include certain corporate bonds and covered bonds as “liquid assets” for purposes of the LCR Test. However, any such bonds would be subject to diversification requirements and haircuts that would not apply to government securities or central bank debt. Banks also would not be permitted to hold more than 50% of their total liquid assets in corporate or covered bonds. It therefore should be assumed that the LCR Test will incentivize banks to increase their holdings of government securities in particular even if certain other obligations ultimately qualify as liquid assets under less favored terms.

possible to anticipate the effect such massive additional securities issuances would have on the global capital markets or the global marketplace.

The Proposals would, in fact, largely deprive banks of one of their most liquid and lowest cost source of funds—the money markets. The rules that govern registered money funds in the United States were recently revised in a manner that will now require registered U.S. money market funds to invest at least thirty percent (30%) of their assets in governmental obligations that mature within 60 days, or other instruments that mature within seven business days. Taxable US money market funds must additionally invest at least ten percent (10%) of their assets in instruments that mature overnight. These money market funds are a huge source of liquidity for issuers who elect to fund themselves through the issuance of very short maturity debt securities. The Proposals, if adopted in their current form, would make it uneconomical for banks to issue any such short-term debt securities, either directly or through financing platforms, such as ABCP conduits or similar platforms that effect issuances of short-term tax exempt instruments. The Proposals would also make it uneconomical for banks to provide unfunded backstop liquidity facilities to corporates and others whose ability to issue rated debt with maturities of less than or equal to 365 days is directly dependent on the presence of such backstop liquidity facilities. Liquidity is currently too scarce in the global capital markets. If the Proposals are adopted in their current form, it appears to us that liquidity will cease to exist in the short-term global capital markets. If this happens, banks, corporates and their customers, state and local governments and investors will be irreparably deprived of low cost funding—it is not possible to envisage the amount of damage this may cause the global economy or all the ways in which such damage may be realized.

Requiring banks to hold a principal amount of high quality assets against one hundred percent (100%) of such banks' short-term indebtedness (net of cash inflows) is excessive and may have fundamental unknown consequences to the global financial markets. Based on our reading of the Proposals and the substance of the existing and proposed bank capital rules, we believe that the implementation of the Proposals would require banks to hold a combination of capital and high quality liquid assets in amounts greater than one hundred percent (100%) of the amount of such short-term indebtedness—a result that appears to us to be overly punitive. We have prepared some examples that we believe illustrate this point—they are attached hereto as Exhibit B. A few of the points highlighted there also include the following:

- (i) if banks are required to acquire large quantities of high quality liquid assets, they will then be required to also correspondingly raise additional permanent capital so as to comply with leverage ratio requirements. This would result in an additional layer of costs associated with banks raising short-term funds to finance client assets and providing liquidity and other funding commitments to such bank clients. For this reason we think it would be appropriate to exempt such high quality liquid assets from the leverage ratio requirements.
- (ii) if banks issue longer term debt to finance the acquisition of high quality assets, such longer term debt will at some point have a remaining term to maturity of thirty days or less, and will have to be fully collateralized by high quality liquid assets. So, for example if we assume that a bank funds the high quality liquid assets with one year debt, each month, across a portfolio of like positions, 1/12th of that debt could be projected to

come due. Therefore, 1/12th of the one year debt amount needs to be included in the net cash outflows portion of the ratio. This requirement would further increase the amount of high quality liquid assets needed by the bank, and the amount of debt that it needs to raise to finance its high quality liquid asset holdings, and so on. The cost of banks financing their acquisition of high quality liquid assets would be expected to be substantially higher than the yield on such high quality liquid assets. This negative carry will depress bank earnings or increase the charges and interest rates charged by banks to borrowers, or both, and so will adversely affect banks (and their shareholders and bank customers).

(iii) the Proposals provide that high quality liquid assets may not be pledged or collateralize bank obligations. We agree that high quality assets should not (a) collateralize short-term bank indebtedness and (b) continue to be considered to be unencumbered (and so available to collateralize some other short-term bank indebtedness). However, banks should be able to pledge high quality liquid assets. The utility of high quality liquid assets as a source of liquidity would largely be lost if the assets could not be pledged or financed by the bank that owns such assets. This type of limitation could, in fact exacerbate a bank's liquidity problem if, at the time of such forced sale, the market value of such assets has fallen below the acquisition price. Recent events in Greece, Portugal, Spain and Ireland have shown that government securities are not immune from significant market value volatility. The Proposals should be changed so as to make it clear that high quality liquid assets may be pledged or used to collateralize debt and such debt will not constitute a "net cash outflow."

We therefore strongly urge that there be some further consideration of the proposed levels at which high quality liquid assets may be required to collateralize banks' short-term funding obligations, and that such levels be calibrated at levels that continue to permit banks to efficiently fund themselves (and support the financing activities of others) in the short-term capital markets.

### **Bank Liquidity Management**

Large, international banks already manage their liquidity exposure through multiple strategies and internal liquidity management strategies. These practices have become much more conservative through the course of the global credit crunch that has occurred through the past several years, and are currently designed to withstand the types of liquidity pressures that have been faced through the events of the credit crunch. As the credit crunch has created liquidity stresses that have not been seen in the global financial markets for almost a century, we believe that these current liquidity practices are very conservative. It is of course possible to design practices that are even more conservative, but as liquidity management becomes more conservative, the amount of liquidity that will be available to the global financial markets will correspondingly be reduced, and will further depress the global marketplace. The Proposals in their current form would constrict liquidity well beyond the measures that banks and their regulators have to date adopted in response to the credit crunch. We do not think it is possible to predict how severely this may affect the global capital markets.



The methods banks currently employ to manage their liquidity positions vary, but without exception banks already manage their “net cash outflows” on a very conservative basis. The elements of this management include an alignment of expected cash inflows with expected cash outflows through different upcoming time periods (e.g., over one day, one week, two week, one month, three month, six month and one year periods). These liquidity management techniques also employ strategies that restrict liquidity outflows during time frames that have been shown to present particular liquidity stresses (e.g., year-end and quarter-end periods of each year). These techniques also include ongoing monitoring of the prices at which collateral financed by banks (or which secures funded or unfunded bank liquidity facilities) may be sold or repo’d by such banks. Banks also allocate significant resources to marketing, provide product information to investors, particularly short-term money market investors, and assure that such banks may continue to place debt products (particularly short-term debt products) to a broad group of investors through multiple dealers of such products, so as to continue to maintain multiple open sources of short-term funding for such banks.

### **ABCP Conduits**

We also have thoughts regarding the potential impact of the LCR on ABCP conduits. These conduits play an important role in providing financing to corporate and other clients. They are more flexible than most securitization platforms and offer asset originators the opportunity to obtain financing secured by diverse pools of receivables. National regulators have recognized the importance of ABCP to the broader economy,<sup>3</sup> and many ABCP conduits have in fact withstood the extreme stress of the last few years and continue to issue commercial paper notes at favorable financing rates. As of March 31, 2010 there was outstanding over U.S.\$401.4 billion<sup>4</sup> and U.S.\$38.3 billion<sup>5</sup> of outstanding ABCP in the U.S. and Euro commercial paper markets, respectively. The LCR could significantly impair the ability of banks to provide liquidity support to ABCP conduits and therefore significantly diminish the availability of ABCP financing.

We recognize that certain segments of the ABCP markets performed poorly after the onset of the global credit crunch. In particular, ABCP issued by “structured investment vehicles” (“SIVs”),

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<sup>3</sup> For example, the Board of Governors of the U.S. Federal Reserve System (the “Federal Reserve Board”) and the U.S. Department of the Treasury established numerous government-sponsored programs to boost the ABCP and other short-term asset-backed securities markets that have been severely impacted by the recent credit crisis, such as the ABCP Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Money Market Investor Funding Facility, the Term Asset-Backed Securities Loan Facility (“TALF”) and the Public Private Investment Program. In its published TALF guidelines, the Federal Reserve Bank of New York stated that:

“The ABS markets historically have funded a substantial share of credit to consumers and businesses. Continued disruption of these markets could significantly limit the availability of credit to households and businesses of all sizes and thereby contribute to further weakening of U.S. economic activity.”

Federal Reserve Bank of New York, Term Asset-Backed Securities Loan Facility, Frequently Asked Questions, [http://newyorkfed.org/markets/talf\\_faq\\_100217.html](http://newyorkfed.org/markets/talf_faq_100217.html) (last visited Apr. 13, 2010).

<sup>4</sup> Federal Reserve Release, Commercial Paper Outstanding, <http://www.federalreserve.gov/releases/cp/outstandings.htm> (last visited Apr. 13, 2010).

<sup>5</sup> Citigroup Global Markets Inc., Global CP Market Update (Apr. 2, 2010).

“SIV-lites”, and other non-bank supported market value financing platforms, including market value CDOs, were unable to satisfy their liquidity needs or issue additional short-term securities from the onset of the credit crunch, and were thereafter effectively shut out of the short-term capital markets. These types of financing platforms did not have access to committed bank liquidity lines in amounts sufficient to provide for the timely payment of one hundred percent (100%) of their outstanding ABCP (in contrast to traditional ABCP conduits (including “Customer Conduits,” as described below), which always benefit from such 100% coverage). Instead, they typically were only required to have approximately fifteen percent (15%) or less of their ABCP covered by committed bank liquidity lines. The short-term markets’ rejection of these types of highly leveraged financing constructs with minimal access to committed liquidity facilities appears to us to have been swift and permanent. These vehicles effectively exited the short-term capital markets in August 2007, and we do not expect that they will return.

We understand and appreciate the Basel Committee’s concerns with these types of financing constructs, and the liquidity stress they imposed on some banks. However, the imposition of the LCR Test across bank contingent liquidity commitments without regard to the circumstances of the particular bank (and its related existing liquidity management policies) and its borrowers (and the related collateral arrangements) does not make sense and will not induce banks to improve their liquidity management policies and practices. Further information gathering by the Basel Committee will be valuable in this regard and should provide information that would permit principled imposition of LCR requirements on a case-by-case basis. Imposition of the LCR Test to the surviving, high quality, traditional ABCP conduit platforms that continue to successfully provide needed financing to the global economy would be too strong of a reaction to these concerns.

If traditional ABCP conduits (and in particular, those traditional ABCP conduits that provide financing to bank customers and satisfy the characteristics described below (the “Customer Conduits”)) are required to satisfy some form of LCR requirement, we suggest that the percentage requirement for such conduits be lowered to a much lower level, consistent with the *de minimus* liquidity risk that these conduits pose to sponsor banks and the broader banking system.

Key defining characteristics of Customer Conduits are:

- Customer Conduits are designed to provide the customers of banks that sponsor Customer Conduits with low-cost funding raised through the issuance of highly rated ABCP into the money markets (in particular, the \$1.7 trillion of money market funds). These funds are applied by such customers for a variety of working capital purposes—including paying employees, financing inventory and other investment and other business purposes. Customer Conduits effectively provide a bridge between the capital resources of the money markets and the financing needs of global businesses.

- Each of a Customer Conduit's investments is individually structured and negotiated by the conduit's sponsor in bespoke transactions, involving direct, one-on-one negotiations with the customer. Through their negotiation of each investment with their customers, sponsors of Customer Conduits typically obtain favorable credit terms that include (a) dynamic credit enhancement, which requires increased collateralization and other support from customers if receivables performance deteriorates; (b) tighter triggers for early amortization or turbo features; and (c) short-term (364 day) commitments to borrowers. Assets financed through partially supported Customer Conduits are not typically financed on a market value basis. Instead, because of the structural features outlined above such investments are not subject to significant market value volatility and so are inherently very liquid. We further note that these positions (i) are typically rated (or internally rated) "A" or "AA" or higher and (ii) constitute a senior position in a financed pool of trade receivables (which represent payment obligations of corporate obligors). We therefore ask that you consider including such highly rated pools of assets financed by Customer Conduits as high quality liquid assets under the Proposals (subject to whatever level of discounting you find to be appropriate for corporate obligations rated within these ratings categories).
- Customer Conduits are actively managed by the conduit sponsor through periodic renewals and monitoring of customer transactions, which give sponsors and Customer Conduits frequent opportunities to renegotiate, re-price or exit deteriorating credits. These features in combination result in such investments having significant liquidity that is constantly refreshed.
- Customer Conduits typically pass their funding cost through to borrowers. This business model minimizes the sponsor bank's exposure to liquidity risk because in times of liquidity stress (and related increases in funding costs) the sponsor bank's customer will either absorb the increased funding cost or elect to repay borrowed amounts. The sponsor bank is therefore not economically compelled to consider purchasing the conduit's notes (so as to avoid having the bank customer's cost of funding assets exceed the bank's unsecured cost of funds—which otherwise might occur if, for example, (i) the conduit lent money to borrowers at a rate of interest that could diverge from the conduit's cost of funding through the issuance of commercial paper notes and (ii) the conduit was unable to issue commercial paper notes except at significantly higher interest rates (due to a global capital markets liquidity crisis of the type suffered during the global markets in 2007 and 2008)).

Largely because of the features described above, Customer Conduits have continued their historically excellent credit performance through the severe tests of recent years. In the process, they have provided an important source of funding and stability to US businesses and profits to their sponsoring banks.

It is true that the LCR is calculated under a 30-day timeframe and that banks could, in theory, minimize the impact of the LCR by requiring their sponsored ABCP conduits to increase the weighted average maturities of their obligations. Most ABCP conduits in fact are authorized to issue commercial paper with maximum terms of either 270 or 397 days. In practice, however, investor demand for ABCP is very much oriented toward the short-term and banks would have little leeway to adjust to the LCR by lengthening maturities. Funding shorter tenors is also

helpful to conduit customers, as it effectively permits them to prepay at any time without penalty. The flexibility often offered to clients to prepay amounts owed also creates a need to have short tenored notes in the event of an unforeseen paydown. As of April 9, 2010, the outstanding ABCP in the U.S. market had an average maturity of 33 days.<sup>6</sup> In addition, many liquidity facilities provided by bank sponsors to ABCP conduits obligate the bank to fund under liquidity agreements in an amount equal to the aggregate face amount of the conduit's outstanding ABCP if the short-term rating of the liquidity bank is downgraded. As the Proposals require banks to hold high quality liquid assets against net cash outflows that may occur if a bank were subject to a ratings downgrade of three credit "notches," it therefore should be assumed that banks will be required to treat as an "outflow" under the LCR the entire undrawn amount of any liquidity facilities that they provide to ABCP conduits (each, an "ABCP Liquidity Facility").

The Proposals state that all net unfunded bank commitments (e.g., liquidity commitment and obligations to fund under stand-by letters of credit) as well as all ABCP with maturities of 30 days or less must be fully collateralized by high quality liquid assets. The Proposals also provide that (i) non-contractual obligations, such as "potential" requests for debt repurchases, should be fully collateralized by high quality liquid assets, and (ii) for issuers with an affiliated dealer or market maker, there may be a need to have all the issuer's debt (both long-term and short-term) with maturities greater than 30 days be fully collateralized by high quality liquidity assets. ABCP conduits typically are structured in a manner that provides for full liquidity coverage (in the form of an unfunded bank liquidity commitment) of the aggregate "face amount" (i.e., principal plus interest through maturity) of all of the conduit's outstanding ABCP. Some conduits are also structured in a manner that provides for an uncommitted liquidity facility sized to cover a portion of the aggregate face amount of the conduits' ABCP. Most conduit structures also provide for a credit facility (which typically takes the form of a letter of credit). The size of the credit facility may vary, consistent with rating agency requirements and the approach taken by the conduit sponsor in designing and marketing the related ABCP program, but for Customer Conduits such credit facilities are typically sized to cover 8–10% of the face amount of outstanding ABCP of such Conduits from time to time. The Proposals as drafted would require that high quality liquid assets be held against the face amount of short-term ABCP, plus the entire liquidity commitment and any uncommitted liquidity that supports such ABCP, plus non-contractual obligations to satisfy potential requests to repurchase debt, plus (for issuers with an affiliated dealer or market maker) the amount of all of the issuer's debt, plus the entire undrawn amount of the letter of credit.<sup>7</sup> This means that if a bank sponsors an ABCP conduit that has \$100 face amount of outstanding ABCP, which is supported by a \$100 unfunded liquidity commitment and a \$10 stand-by letter of credit provided by such bank, the bank would be required to hold multiples of high quality liquid assets against each of these obligations, notwithstanding that the bank could not be called to fund an amount greater than \$100 in any circumstance. The Proposals should be changed so that it is clear that any single financing is not

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<sup>6</sup> Federal Reserve Release, Maturity Distribution of Outstanding Commercial Paper, <http://www.federalreserve.gov/releases/cp/maturity.htm> (last visited Apr. 13, 2010).

<sup>7</sup> The amount of liquid assets required to be held technically would be the excess of these amounts over the cumulative expected amount of associated cash inflows during the 30 day window. In practice, however, the amount of expected cash inflows for an ABCP conduit over any particular calculation period could be minimal or zero and banks therefore could be required at times to hold liquid assets equal to the full amount of the potential cash outflows (calculated as above) without deduction for any anticipated receipts.

required to be supported by multiple amounts of high quality liquid assets. In addition, we believe that the Proposals should be clarified so that bank assets, such as loans made by conduits (which are consolidated onto bank-sponsor balance sheets in accordance with recently-revised U.S. GAAP standards) that have related exposures that require high quality liquid assets under the LCR, should be assigned zero percent (0%) “required stable funding” factors in determining the required amount of stable funding for purposes of compliance with the “net stable funding ratio” test.<sup>8</sup> High quality liquid assets held by banks should be considered to be inherently liquid—the banks should not have to maintain duplicative additional sources of stable funding for these assets.

We believe that requiring banks to hold high quality liquid assets in a principal amount that (after haircuts) equals one hundred percent (100%) of the bank’s undrawn commitments under ABCP Liquidity Facilities is excessive (as described above, the LCR as currently drafted would require bank sponsors of ABCP conduits to hold more than twice this amount of high quality liquid assets). We believe that the LCR should be revised to treat as an outflow only a “stressed” percentage of the actual liquidity draws that, based on historical experience, might reasonably be expected to be made on the support providers to Customer Conduits. Note also that banks’ liquidity management procedures already factor in the liquidity needs of their managed ABCP conduits and the maturity, credit and liquidity profile of these conduits assets as well as the maturity profile of the issued ABCP.

Our comment above regarding Customer Conduits (i.e., that the LCR “outflow” definition is not sufficiently calibrated to the actual level of risk) can be extended to other categories of bank commitments. As an example, most corporate issuers of commercial paper are required to maintain backup bank liquidity facilities in order to obtain the necessary short-term ratings. In practice, these facilities are rarely accessed and drawings by creditworthy issuers are usually modest in amount. The LCR nonetheless requires banks to treat as an “outflow” 100% of their commitment amounts under liquidity facilities extended to non-financial corporates (other than in respect of obligations that will mature later than 30 days after the calculation date). This approach will discourage and/or prevent banks from continuing to provide backup liquidity facilities to corporate commercial paper issuers and could thereby greatly reduce the amount of cost-effective short-term financing available to such borrowers. We therefore strongly urge the Basel Committee to give further consideration to the proposed levels at which high quality liquid assets may be required to collateralize banks’ short-term funding obligations, and that such levels be calibrated at levels that continue to permit banks to efficiently fund themselves (and support the financing activities of others) in the short-term capital markets.

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<sup>8</sup> Please see paragraphs 89 and 91 of the Liquidity Risk Consultative Document.

## **Conclusion**

Adoption of the Proposals in their current form will have fundamental effects on the global capital markets, some of which may not yet be clear or identifiable. It is clear that implementation of these Proposals will increase bank funding costs, reduce bank profitability and dramatically decrease the amount of capital markets funded liquidity available to corporates, states, municipalities, small business and individuals. We ask that the Basel Committee consider the specific recommendations set forth herein.

ASF thanks the Basel Committee for this opportunity to comment on the Consultative Documents. If you have any questions concerning these comments, or would like to discuss these comments further, please feel free to contact me directly at 212.412.7107 or at [tdeutsch@americansecuritization.com](mailto:tdeutsch@americansecuritization.com).

Sincerely,

A handwritten signature in black ink that reads "Tom Deutsch". The signature is written in a cursive, flowing style.

Tom Deutsch  
Executive Director  
American Securitization Forum

## Exhibit A

### **The Role and Importance of Securitization to the Financial System and U.S. Economy**

#### *Background and History*

In order to understand the full impact that the Proposals would have on the securitization industry, it is important to recognize the importance of securitization to the U.S. and world economies. Securitization generally refers to the process by which consumer and business assets are pooled and securities, the payment of which depends primarily on the performance of those underlying assets, are issued in the capital markets.

Securitization plays an essential role in the financial system and the broader U.S. economy. Over the past 25 years, securitization has grown from a relatively small and unknown segment of the financial markets to a mainstream source of credit and financing for individuals and businesses, representing a vital sector of today's financial markets. It is estimated that securitization has funded between 30% and 75% of lending in various markets, including an estimated 59% of outstanding United States home mortgages.<sup>1</sup> Securitization plays a critical role in non-mortgage consumer credit as well. Historically, most banks have securitized 50–60% of their credit card assets.<sup>2</sup> Meanwhile, in the auto industry, a substantial portion of automobile sales are financed through auto ABS.<sup>3</sup> Overall, recent data collected by the Board of Governors of the U.S. Federal Reserve System (the “Federal Reserve Board”) shows that securitization has provided over 25% of outstanding U.S. consumer credit.<sup>4</sup> Securitization also provides an important source of commercial mortgage loan financing throughout the U.S. and the world, through the issuance of commercial mortgage-backed securities (“CMBS”).

#### *Benefits of Securitization*

Over the years, securitization has grown in large measure because of the benefits and value it delivers to transaction participants and to the financial system. Among these benefits and value are the following:

- **Efficiency and Cost of Financing.** By linking financing terms to the performance of a discrete asset or pool of assets, rather than to the future profitability or claims-paying potential of an operating company, securitization often provides a cheaper and more efficient form of financing than other types of equity or debt financing.
- **Incremental Credit Creation.** By enabling capital to be recycled via securitization, lenders can obtain additional funding from the capital markets that can be used to support incremental credit creation. In contrast, loans that are made and held in a financial institution's portfolio occupy that capital until the loans are repaid.

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<sup>1</sup> Citigroup Global Markets Inc., *Does the World Need Securitization?*, ¶ 10–11 (2008), [http://www.americansecuritization.com/uploadedFiles/Citi121208\\_restart\\_securitization.pdf](http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf).

<sup>2</sup> *Id.*, ¶ 10.

<sup>3</sup> *Id.*

<sup>4</sup> Federal Reserve Statistical Release, Consumer Credit, <http://www.federalreserve.gov/releases/g19/20090908> (last visited Sept. 8, 2009).

- **Credit Cost Reduction.** The economic efficiencies and increased liquidity available from securitization can serve to lower the cost of credit to consumers. Several academic studies have demonstrated this result. A recent study by National Economic Research Associates, Inc., concluded that securitization lowers the cost of consumer credit, reducing yield spreads across a range of products including residential mortgages, credit card receivables and automobile loans.<sup>5</sup>
- **Liquidity Creation.** Securitization often offers issuers an alternative and cheaper form of financing than is available from traditional bank lending, or debt or equity financing. As a result, securitization serves as an alternative and complementary form of liquidity creation within the capital markets and primary lending markets.
- **Risk Transfer.** Securitization allows entities that originate credit risk to transfer that risk to other parties throughout the financial markets, thereby allocating that risk to parties willing to assume it.
- **Customized Financing and Investment Products.** Securitization technology allows for precise and customized creation of financing and investment products tailored to the specific needs of issuers and investors. For example, issuers can tailor securitization structures to meet their capital needs and preferences and diversify their sources of financing and liquidity. Investors can tailor securitized products to meet their specific credit, duration, diversification and other investment objectives.<sup>6</sup>

#### *Government Recognition of the Importance of Securitization*

Recognizing these and other benefits, policymakers globally have taken steps to help encourage and facilitate the recovery of securitization activity. At the height of the global credit crunch the G-7 finance ministers, representing the world's largest economies, declared that "the current situation calls for urgent and exceptional action . . . to restart the secondary markets for mortgages and other securitized assets."<sup>7</sup> The U.S. Department of the Treasury (the "Treasury Department") stated that "while the intricacies of secondary markets and securitization . . . may be complex, these loans account for almost half of the credit going to Main Street,"<sup>8</sup> underscoring the critical nature of securitization in today's economy. In 2008, the Chairman of the Federal Reserve Board noted that securitization "provides originators much wider sources of funding than they could obtain through conventional sources, such as retail deposits" and also that "it substantially reduces the originator's exposure to interest rate, credit, prepayment, and other risks."<sup>9</sup> Echoing that statement, Federal Reserve Board Governor Elizabeth Duke stated in

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<sup>5</sup> National Economic Research Associates, Inc. (NERA), *Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets*, ¶ 16 (2009), [www.americansecuritization.com/uploadedFiles/ASF\\_NERA\\_Report.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf).

<sup>6</sup> The vast majority of investors in the securitization market are institutional investors, including banks, insurance companies, mutual funds, money market funds, pension funds, hedge funds and other large pools of capital. Although these direct market participants are institutions, many of them—pension funds, mutual funds and insurance companies, in particular—invest on behalf of individuals, in addition to other account holders.

<sup>7</sup> Press Release, U.S. Department of the Treasury, G-7 Finance Ministers and Central Bank Governors Plan of Action (Oct. 10, 2008) (on file with author), <http://www.treas.gov/press/releases/hp1195.htm>.

<sup>8</sup> U.S. Department of the Treasury, Road to Stability: Consumer & Business Lending Initiative (Jul. 17, 2009), [www.financialstability.gov/roadtostability/lendinginitiative.html](http://www.financialstability.gov/roadtostability/lendinginitiative.html) (last visited Apr. 13, 2010).

<sup>9</sup> Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Speech at the UC Berkeley/UCLA Symposium: The Mortgage Meltdown, the Economy, and Public Policy, Berkeley, California: The



September 2009 that the “financial system has become dependent upon securitization as an important intermediation tool,”<sup>10</sup> and the International Monetary Fund (the “IMF”) noted in its *Global Financial Stability Report* issued in October 2009 that “restarting private-label securitization markets, especially in the United States, is critical to limiting the fallout from the credit crisis and to the withdrawal of central bank and government interventions.”<sup>11</sup> There is clear recognition in the official sector of the importance of the securitization process and the access to financing that it provides lenders, and of its importance to the availability of credit that ultimately flows to consumers, businesses and the real economy.

Restoration of function and confidence to the securitization markets is a particularly urgent need, in light of capital and liquidity constraints currently confronting financial institutions and markets globally. With the process of bank de-leveraging and balance sheet reduction still underway, and with increased bank capital requirements on the horizon, the funding capacity previously provided by securitization cannot be replaced with deposit-based financing alone in the current or foreseeable economic environment. In October 2009, the IMF estimated that a financing “gap” of U.S.\$440 billion will exist between total U.S. credit capacity available for the nonfinancial sector and U.S. total credit demand from that sector for the year 2009.<sup>12</sup> Moreover, non-bank finance companies, which have played an important role in providing financing to consumers and small businesses, are particularly reliant on securitization to fund their lending activities, since they do not have access to deposit-based funding. Small businesses, which employ approximately 50% of the United States workforce, depend on securitization to supply credit that is used to pay employees, finance inventory and investment, and other business purposes. A lack of financing for mortgages hampers the housing industry. A constriction of trade receivable financing can adversely affect employment opportunities in the manufacturing sector. Simply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy. The recovery and restoration of confidence in securitization is therefore a necessary ingredient for economic growth to resume, and for that growth to continue on a sustained basis into the future.

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Future of Mortgage Finance in the United States (Oct. 31, 2008), [www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm](http://www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm).

<sup>10</sup>Elizabeth A. Duke, Governor, Board of Governors of the Federal Reserve System, Speech at the AICPA National Conference on Banks and Savings Institutions, Washington, D.C.: Regulatory Perspectives on the Changing Accounting Landscape (Sept. 14, 2009), [www.federalreserve.gov/newsevents/speech/duke20090914a.htm](http://www.federalreserve.gov/newsevents/speech/duke20090914a.htm).

<sup>11</sup>INT’L MONETARY FUND, NAVIGATING THE FIN’L CHALLENGES AHEAD, GLOBAL FIN’L STABILITY REPORT (2009), ¶ 77, <http://www.imf.org/External/Pubs/FT/GFSR/2009/02/pdf/text.pdf>.

<sup>12</sup>Id. ¶ 34.

Exhibit B

[Please see attached]

## The additive effects of the two proposals are clearly evident in traditional banking businesses that performed well through the crisis

- The summary sheet brings together the results computed on the detail sheets
  - The left column computes the cost of regulatory compliance under the currently applicable Basel rules (assumes Basel II)
  - The right column describes the costs implied by the proposals under review
  - There are various elements that contribute to the increases
  - They're broken out by Tier 1 capital, leverage ratio and liquidity coverage ratio, with the costs totaled
- The additive effects illustrated in this analysis are comparable to other traditional high quality lines of business that performed very well throughout the crisis
  - vanilla senior securitization (prime RMBS warehousing, trade receivables, prime credit cards, auto loans, student loans etc.)
  - Municipal finance activities
  - Medium enterprise lending
  - Investment grade corporate commitment facilities
- See the detail sheets to trace the derivation of each result

### Basel Capital Proposal Quantitative Example

\$100M AAA-rated Conduit Asset  
Summary of implied costs

	Current	Proposed	Description
<b>Tier 1 Capital</b>			
Total Capital \$	\$0.76	\$0.76	Increased PD per Procyclicality proposal
Capital Cost %	12%	18%	Narrowing definition of Tier 1 Capital
<b>Tier 1 Capital Cost bps</b>	<b>9.2</b>	<b>13.8</b>	
<b>Leverage Ratio</b>			
Add'l Capital for Undrawn Portion \$	\$0.28	\$4.34	Undrawn amounts included in leverage ratio
Add'l Capital for HQ Assets \$	\$0.65	\$4.94	HQ Assets from liquidity ratio hit leverage ratio
Total Add'l Capital \$ (above Tier 1)	\$0.93	\$9.27	
Capital Cost %	12%	18%	
<b>Leverage Ratio Capital Cost bps</b>	<b>11.2</b>	<b>166.9</b>	
<b>Liquidity Ratio</b>			
Liquidity Reserve above Tier 1 \$	\$23.30	\$98.14	High Quality Assets required for 100% reserve
Cost of 1 yr Debt	0.50%	0.50%	
<b>Liquidity Ratio Debt Cost bps</b>	<b>11.7</b>	<b>49.1</b>	
<b>Total Regulatory Cost of Lending</b>	<b>32</b>	<b>230</b>	

## The cost of Tier 1 Capital is impacted by both adjustments for procyclicality and the narrowing of the composition

- The "Tier 1" sheet details the computation of tier 1 capital under the current regime (left column) and under the proposed rules (right column)
- The first element of additional cost to identify on this sheet is the increase in PD (probability of default) which is implied by the efforts to combat procyclicality
  - These proposals seek to increase the probabilities of default used in the capital calculation from a projection of the next year's rate to the highest annual rate observed through economic cycles
  - This in turn increases the RAA attributable to the position, and therefore the amount of capital and its cost.
- The second element of increased cost to identify on this sheet results from the narrowing of the definition of acceptable Tier 1 capital instruments
  - The proposal suggests that essentially only common stock would be counted as Tier 1 capital
  - As a result, the cost of generating Tier 1 capital is projected to increase significantly
  - Internal estimates project cost increases of as much as 50%
  - this is reflected in the "Cost of Tier 1 Capital" cells in this sheet

### Basel Capital Proposal Quantitative Example

#### \$100M AAA-rated Conduit Asset Tier 1 Capital Ratio Analysis

	Current	Proposed
Commitment	\$100	\$100
Liquidity	\$102	\$102
Credit	\$10	\$10
RAA		
Liquidity	\$6.44	\$6.44
Credit	\$1.20	\$1.20
RAA \$	\$7.64	\$7.64
Tier 1 Capital	10%	10%
Attributed Capital	\$0.76	\$0.76
Cost of Tier 1 Capital	12%	18%
Total Capital Cost (\$)	\$0.09	\$0.14
<b>Total Capital Cost (bps)</b>	<b>9.2</b>	<b>13.8</b>

Increased PD  
to address pro-  
cyclicality (no  
impact here)

Increased  
Tier 1 capital  
cost due to  
narrowed  
definition

## The calibration and boundaries of the Leverage Ratio could have a very substantial impact on the cost of providing credit

- The "Leverage" sheet details the computation of the leverage ratio under the current regime (left column) and under the proposed rules (right column).
- The first element of additional cost to identify on this sheet is the inclusion of undrawn commitments to the "Exposure Measure"
  - Under current rules, undrawn commitments are not included in the leverage ratio exposure measure
  - Including this value as an exposure greatly increases the amount of capital needed to meet the ratio's requirements
  - To complicate matters, even the requirement is as yet undefined, and as such the "Leverage Ratio Target" remains a variable input in this sheet
  - This example assume a 20x leverage ratio that is held constant
- The second element of increased cost to identify on this sheet is generated by the liquidity coverage ratio (see below)
  - As a result of the need to purchase a much higher buffer of "high quality assets" to meet the liquidity coverage ratio, the exposure measure of the leverage ratio is itself greatly increased by the value of the high quality assets purchased
  - Again, this increases the amount of equity that must be raised and therefore the costs
  - Calculation of additional required capital is an iterative process with interdependencies between ratios

### Basel Capital Proposal Quantitative Example

#### \$100M AAA-rated Conduit Asset Leverage Ratio Analysis

leverage ratio = capital measure / exposure measure

Target  
**5%**

	Current	Proposed
Commitment	\$100	\$100
Liquidity	\$102	\$102
Credit	\$10	\$10
RAA		
Liquidity	\$6.44	\$6.44
Credit	\$1.20	\$1.20
RAA \$	\$7.64	\$7.64
Tier 1 Capital	10%	10%
Tier 1 Capital	\$0.76	\$0.76
Add'l reqrd capital for HQA and Leverage	\$0.93	\$9.27
<b>Capital Measure</b>	<b>\$1.70</b>	<b>\$10.04</b>
Exposure (currently Credit, proposed All)	\$10	\$102
Additional Stock of High Quality Assets	\$23	\$98
<b>Exposure Measure</b>	<b>\$33</b>	<b>\$200</b>
<b>Leverage Ratio</b>	<b>5.09%</b>	<b>5.01%</b>
Cost of additional required capital (\$)	\$0.11	\$1.67
<b>Cost of additional required capital (bps)</b>	<b>11.2</b>	<b>166.9</b>

Undrawn  
commitments  
now included

HQ Assets  
from liquidity  
ratio hit the  
leverage  
ratio

## The Liquidity Coverage Ratio further amplifies the problems associated with the interaction of the two proposals

- The "Liquidity" sheet details the computation of the liquidity coverage ratio under the current regime (left column) and under the proposed rules (right column)
- The first element of additional cost to identify on this sheet is the need to purchase high quality assets (HQA) to more than fully pre-fund undrawn commitments. Stock of high quality assets is at least as great as the cash outflows projected in the next 30 days.
  - Note that for the purposes of this calculation, undrawn commitments are fully included in the cash outflows
  - Also note that these high quality assets impact the leverage ratio above, as previously described
- The second element of increased cost to identify on this sheet is generated by the debt issued to purchase the high quality assets
  - If we assume that we fund the high quality assets with 1 year debt, each month, across a portfolio of like positions, 1/12th of that debt could be projected to come due
  - Therefore, 1/12th of the debt amount needs to be included in the net cash outflows portion of the ratio as "Debt issuance maturing under 30 days"
  - This further increases the amount of high quality assets needed, and the debt that needs to be raised, and so on

### Basel Capital Proposal Quantitative Example

#### \$100M AAA-rated Conduit Asset

#### Liquidity Ratio Analysis - Interpret requirement as full funding

Assume Tier 1 capital forms the equity component of the capital structure  
Assume long term debt raised to fund the remaining liquidity requirement

	Current \$	Current %	Proposal \$	Proposal %
Commitment	\$100.0		\$100.0	
HQA Funded by Tier 1 Capital	\$1.70	1.7%	\$10.0	10.0%
HQA Funded by Debt	\$23.30	23.3%	\$98.1	98.1%
<b>Stock of High Quality Assets</b>			<b>\$108.2</b>	
Debt issuance maturing under 30 days			\$8.2	
Commitment			\$100.0	
<b>Net Cash Outflows</b>			<b>\$108.2</b>	
<b>Liquidity ratio (HQA/Outflows)</b>				<b>100.0%</b>
1yr debt cost	\$0.12	0.50%	\$0.49	0.50%
<b>Debt cost (bps on Commit)</b>		<b>11.7</b>		<b>49.1</b>

HQ Assets  
must be  
purchased to  
meet net  
cash outflows

Portion of  
debt used to  
fund HQ  
Assets hits  
ratio



## **We support and agree with the goals, but the current framework has very substantial interdependencies that need further evaluation**

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- **The current proposals introduce substantial costs to banks that seek to provide traditional lending activities – activities that benefit institutional as well as individuals**
  - The amount and nature of the costs are complicated to isolate due to the proposed construct
  - National differences in banking regulation, products and accounting will make it extraordinarily difficult to precisely assess the pro forma impact of this framework
  - Further complicating this problem is the current QIS does not pick up these effects in a concise and obvious way
- **We have very substantial concerns with the Liquidity Proposal particularly as it relates to a Pillar 1 implementation**
  - The assumptions underlying the proposal are extraordinarily conservative and threaten to materially reduce credit availability and increase the cost of available credit
  - Pillar 2 exists today and can be used effectively to prudently manage and regulate liquidity risk for banking institutions
- **We are very concerned that proposed reform does not contemplate Central Bank involvement even if assumptions imply a severe systemic stress**
  - The current reform proposals ignore much of what was learned and worked during the crisis and to assume that banks need to 100% self-insured against a severe systemic stress creates the real possibility of:
    - destabilizing forces in another crisis
    - undesirable credit constraints and macro-economic implications
    - Apparent cliff effects in certain systemic crisis scenarios
- **We are extremely concerned with the very short implementation time frame particularly when combined with all of the other regulatory reform (e.g. accounting changes, market related reform, etc.) at a time when careful attention is being paid to economic recovery**