April 15th 2010

Subject: **Comments of the "Club of Long Term Investors" (LTIs) on the Consultative Document "International framework for liquidity risk measurements, standards and monitoring" issued by the Basel Committee on Banking Supervision**

Ref : "International framework for liquidity risk measurement, standards and monitoring - consultative document", http://www.bis.org/publ/bcbs165.htm, issued on Dec 2009

Dear Sir, Dear Madam;

LTIs want to underline that they support these new standards that also respond to recommendations of the G20 that called for the Committee to "....enhance tools, metrics and benchmarks that supervisors can use to assess the resilience of banks' liquidity cushions and constrain any weakening in liquidity maturity profiles, diversity of funding sources, and stress testing practices". Furthermore, the G20 recommended that "...the BCBS and national authorities should develop and agree by 2010 a global framework for promoting stronger liquidity buffers at financial institutions, including cross-border institutions."

You will find below our comments on the consultative document "International framework for liquidity risk measurements, standards and monitoring".

We remain at your disposal to explain, and if needed elaborate further on these issues

Yours Sincerely,

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1. The nature and business model of "LTIs"

The "club of long term investors" or LTIs, are long term investors that share the same specific special features as description below.

Four public institutions are mainly contributing to the reflexions of the "LTIs club" even if this club composition is meant to be enlarged to other European institutions. The 4 contributors to this note are :

- KfW
- European Investment Bank

- Cassa Depositi e Prestiti
- Caisse des Dépôts

The business model of most LTIs is essentially different from that of banks. The function of most LTIs is to a much lesser extent a maturity transformation activity as compared to banks. Namely, LTIs invest and provide funding to long term projects considered eligible based on financial and public utility criteria.

Another characteristic of LTIs is that they invest with no objective of short term value gains. On the contrary they have an objective of long term revenues or dividends. This is true for all assets, including some very liquid assets as liquid equity securities. Therefore the liquidity classification of an asset can also depend on the management intent in holding the asset. In this respect, LTIs can accept to have reinforced constraints on liquidity, provided that the long term investment logic is recognised with the possibility to account for those assets in a way that is coherent with their long term strategic investment nature, instead of Mark to market.

This specific nature of LTIs is reflected in the behaviour of investors towards their liabilities, which are characterized by "flight to quality" dynamics in situations of generalized liquidity stress[1]. In other words, LTIs liabilities are considered safer than banks liabilities in periods of liquidity tension on the financial markets.

The credit and liquidity characteristics of LTIs liabilities are recognized by the Basel Committee. In most cases, under the Standardized Approach of Basel 2, banks are not required to hold any prudential capital vis-à-vis their holdings of LTIs bonds and the latter are considered to be eligible "liquid assets" for the calculation of the Liquidity Coverage Ratio.

The specific business model of LTIs is strongly influencing their approach to liquidity risk measurement and management.

It is recalled that LTIs are generally not subject to regulatory supervision based on the Basel Committee principles. However, LTIs aim to comply in substance with such principles and, in general, with banking best practices, as long as these are coherent with their long term goals.

Should LTIs decide to implement the ratios suggested in the Basel Committee document, on a voluntary basis and for indicative purposes, the approach and the rules should be adapted in order to take in account their specificities.

2. The main comments on the proposed document are :

1. LTIs are characterized by "flight to quality" dynamics in situations of generalized liquidity stress, so we ask to renew a significant part of our funding in the calculation of the ratios (*Unsecured wholesale funding provided by other legal entity customers)*

2. We would like the document to be more precise in the inclusion of financial instruments issued by state owned public institutions, state guaranteed institutions and LTIs in the high quality liquid assets category.

3. Some LTIs do have specific monopolistic and state-regulated deposits. We consider that such deposits are not volatile, and request that they should be attributed a very good coefficient, even better than the best coefficient of the norm (applied to retail deposits).

4. LTIs do have specific commitments "at risk" of disbursement that do not take the form of "revolving". Only a small portion of such facilities would be drawn by non-financial corporate counterparties. We request to take this particularity into account and do not consider that 100% will be drawn immediately as specified in the document.

[1] This phenomenon has been evident at the beginning of the acute phase of the sub-prime financial crisis in June 2007, when Credit Default Swap (CDS) spreads on European banks have substantially increased, while the credit spread quoted on LTIs issues has decreased.

ANNEX : Detailed comments.

Comments on the Liquidity Coverage Ratio (LCR) proposal

Comment on § 22

The Basel committee suggest as part of its stress scenario a three-notch downgrade in the institutions's public credit rating. As all LTIs are directly or indirectly guaranteed by their sovereigns, this downgrade would mean that sovereigns would meet a massive loss in their credit rating. This is very unlikely to happen in such a short period of time as suggested in the proposal. Also the Basel Committee seems to have that view on sovereigns. Therefore, we believe a three-notch downgrade within a month to be inappropriate concerning LTIs. For LTIs, we suggest that a maximum of one notch downgrade should be simulated.

Comment on § 26 :

The Basel Committee proposal does not clarify in detail the treatment to be given to those High Quality Assets that are provided to a financial institution as collateral to derivative transaction. Own assets that are encumbered are excluded from the computation of the numerator of the LCR, and this appears reasonable. However, the high quality assets that have been posted to the bank by counterparties to derivative transaction are not given any explicit consideration. It would be advisable to have explicit guidance with respect to whether such assets can be assigned to the numerator of the LCR and, in affirmative case, whether specific conditions, "haircuts" or corrective parameters whatsoever should be applied.

Comment on § 32 :

The document states that "*A bank should periodically monetise a proportion of the assets in its liquid assets buffer through repo or outright sale to the market in order to test the usability of the assets*".
We believe that a test of the possibility to monetise a proportion of the assets can be done by asking prices to at least two counterparties in the market, but that it is not necessary to really conclude operations.
Moreover, the test that will be conducted in normal situations periods will not reflect potential problems that could occur in a period of stress.

Comment on § 34 (a) :

We would like to have a more precise indication of what falls in this category "cash". Indeed, does it include cash deposits in a bank ?
This comment also applies to § 89.

Comment on § 34 (c) :

We would like the document to be more precise in the inclusion of non-central government public sector entities (PSEs) and multilateral banks.
Indeed, the norm should clearly and explicitly specify that the financial instruments issued by state owned public institutions are included in the perimeter of high quality liquid assets.
In the same way, the norm should clearly and explicitly specify that the financial instruments issued by Long Term Investment financial institutions, and especially LTIs, are included in the perimeter of high quality liquid assets.
This comment also applies to § 89.

Comment on § 34 (c) (iii) :

First of all, with the aim of enlarging the portfolio of eligible liquid assets, we are in favour of including corporate and covered bonds among the High Quality Liquid Assets to be considered in the numerator of the LCR, albeit with 20% or 40% haircuts and subject to some conditions for their marketability. This would allow to reduce the pressure on government bonds as the principal source of liquidity in situation of stress.
In addition, we note that marketable securities issued by banks are not considered by the Basel Committee paper as liquid assets eligible to be included in the numerator of the LCR ratio. Here, we believe that it is wise to take into account the "wrong way risk" that banks would incur in holding assets issued by other banks for liquidity purposes. However, we also consider that marketable securities issued by banks could continue to offer some protection, even in situations of significant liquidity stress albeit at the price of significant haircuts in the case of forced liquidation[2].
This aspect should be considered by the Basel Committee in setting guidelines that do not completely rule out bank's securities from the calculation of the LCT, even if such assets should be subject to rigorous haircuts and prudent diversification criteria.
This comment also applies to § 89.

Comment on § 34 (d) :

It should be clarified if loans granted to public sector entities and paid by the central government are included under letter d). Indeed, state-guaranteed assets should be clearly included.

Comment on § 41 – 48 :

Some LTIs do have specific monopolistic and state-regulated deposits, for example consignations or notaries transactions deposits. In fact, those deposits are regulated by law and are not comparable to corporate deposits nor retail deposits. Indeed, their evolution is quite different from retail or corporate deposits while there is no possibility to claim those deposits in case of crisis or for any other reason than very specific regulated conditions : consignations can only be drawn only circumstances foreseen by the law; notary deposits can only be drawn at the conclusion of the real estate transaction.
This is the reason why we consider that such deposits should be attributed a very low coefficient, even lower than the lower coefficient applied to retail deposits (i.e. 7,5%).

Comment on § 55- 56 :

In the proposal by the Basel Committee, the "*Unsecured wholesale funding provided by other legal entity customers*" with maturity shorter than one month are considered in full (i.e.: given a weight of 100%) among the cash outflows in the calculation of the denominator of the short-term LCR.
According to the Basel Committee proposal, all notes, bonds and other debt securities are included in this category unless the counterparty is known to be a retail customer, a small business customer or a non-financial corporate customer.
From the point of view of LTIs, we consider that a lower weighting should be applied to the "*Unsecured wholesale funding provided by other legal entity customers*" for marketable securities issued by the LTIs (bonds and commercial paper). In other words, the fact that bonds and commercial paper issued by LTIs preserve and even increase their attractiveness in periods of market stress, should be recognised by a more favourable treatment of this category of liabilities in the calculation of the short-term LCR as compared to what it is permitted to banks. In fact, we would like the norm to admit that a portion of LTIs commercial papers will be rolled out, and also a (smaller) part of bonds will be rolled out. As a matter of fact, the document of the Basel Committee defines bonds issued by LTIs as "liquid assets" eligible to be used in the numerator of the LCR by banks. It appears contradictory that, in the calculation of the LCR from LTIs point of view, own bonds with maturity shorter than 1 month are considered to be at high risk of being not renewed (i.e.: given a weight of 100%).

We also observe that banks may have the possibility of identifying the portion of wholesale funding held by retail customers as they often manage autonomously their "book" of bond issuance. On the other hand,

[2] For instance, even in the acute phase of the crisis, it was not uncommon to observe prices in the region of 30%-40% of principal amount for bonds issued by banks.

LTIs do not have the concrete possibility of tracking bond counterparties. As such, based on the current version of the consultative paper, LTIs would find themselves in the situation of weighting at 100% practically all their liabilities that have maturity lower than one month, even where such liabilities could be held by retail investors for a sizeable portion.

Comment on § 58 :

The norm states that it is possible to renew secured funding on short term transaction for High Quality Liquid Assets.
We believe that this position is inconsistent with the definition of High Quality Liquid Assets, that should be the projected amount unencumbered after 30 days (so that the assets put in repo for less than 30 days would be considered in the numerator).

Comment on § 66 :

In the calculation of the cash outflows in the denominator of the LCR, the "*draws on committed credit and liquidity facilities*" are attributed predefined weights depending on the client's nature. In particular, a weight of 10% is attributed to for draw-downs on committed credit facilities to *non-financial* corporate customers, whereas a weight of 100% is given to for draw-downs on committed credit and liquidity facilities to *financial* institutions. In other words the guidelines by the Basel Committee assume that almost all the allotted credit and liquidity facilities would be drawn by financial counterparties in case of need, while only a small portion of such facilities would be drawn by non-financial corporate counterparties.

Some specific commitments "at risk" of disbursement do not take the form of "revolving" credit lines. This is the case for example for a sizeable portion of committed credit facilities that have future already scheduled disbursements linked to the fulfillment of technical advancements on the financed project (e.g. project financing, infrastructure, constructions, etc.). The disbursements cannot be anticipated simply at the counterparty's request.

For this type of credit lines, we would like to take their specificities into account, and not disburse immediately the part that is positioned in the future.

Comment on § 76 :

The norm states that there is no possibility to use any draws on lines of credit or liquidity facilities. We believe that this position is very stressful and means that all banks are in default at the same time. We would rather consider those instruments, even with some haircut.

Moreover, not including those instruments would be in our mind counterproductive since it would lead banks to abandon the conclusion of credit lines in order to protect themselves from individual defiance on their name.

Comments on the Net Stable Funding Ratio (NSFR) proposal

Comment 1 on § 86 :

In the calculation of the Available Stable Funding (i.e. the numerator of the NSFR), the unsecured wholesale funding which has a residual maturity shorter than one year and is not provided by non-financial corporates is given a 0% weight, i.e. there is an implicit assumption that in condition of stress such a type of funding will not be rolled-over. The bonds issued by LTIs would basically fall into this category, i.e. in situation of liquidity stress the LTIs would not be able to refinance *any* bond or commercial paper that comes to maturity for a period of one year. The experience of the 2007-2008 liquidity crisis has proven that the contrary is true, as LTIs lending programs and related funding activities have even increased as compared to the past (due to flight to quality). Then a remark similar to point 55-56 is valid: if, for example,

the Basel Committee indicates that banks can consider EIB bonds to be liquid assets, then the issuer of such securities should be given the ability to use a very high weighting (e.g. 75% to 100%) for own liabilities with maturity shorter than one year. This would mean making the implicit assumption that LTIs can rollover a substantial part of its maturing liabilities even in conditions of market stress.

Comment 2 on § 86 :

Some LTIs do have specific monopolistic and state-regulated deposits, like consignations or notaries transactions deposits. In fact, those deposits are regulated by law and are not comparable to corporate deposits nor retail deposits. Indeed, their evolution is quite different from retail or corporate deposits while there is no possibility to claim those deposits in case of crisis or for any other reason than very specific regulated conditions : consignations can only be drawn only in legal circumstances; notary deposits can only be drawn at the conclusion of the real estate transaction.
This is the reason why we consider that such deposits should be attributed a very high coefficient, even higher than the highest coefficient applied to retail deposits(i.e. 85%).

Comment 1 on § 89 :

The norm states that "all other assets" are considered with a coefficient of 100%, then bank bonds that are normally eligible for repo market are not included. We believe that 100% is too restrictive and that a smaller coefficient should be applied.

Comment 2 on § 89 :

On the 5% category, we have the same remark that for 34.c.
The norm should clearly and explicitly specify that the financial instruments issued by state owned public institutions are included in the perimeter of high quality liquid assets.
In the same way, the norm should clearly and explicitly specify that the financial instruments issued by Long Term Investment financial institutions, and especially LTIs, are included in the perimeter of high quality liquid assets.

Comment 3 on § 89 :

About the renewal of Loans to retail clients with maturity of less than one year, we believe that the 85% is too restrictive. In fact, when short term consumption loans are very likely to be renewed, this is not the case for long term loans most of which are mortgage loans and have little probability of being renewed.
Same comment applies to loans to non-financial corporate clients with a residual maturity less than one year (short term facilities vs long term loans).

Comments on the Monitoring Tools proposal

From a general point of view, we consider that the monitoring tools proposed under Section III could be taken into consideration by the national regulators in the context of the Supervisory Review Process, rather than being treated as mandatory elements of a possible supervisory reporting framework for liquidity risk.

Specific comments on two of the proposed monitoring tools are illustrated in what follows.

Comment on § 95 :

A monitoring tool similar to the *"Contractual Maturity Mismatch"* is in place at LTIs. We believe that this type of analysis might suit the LTIs, provided that the specificities of each institution can be taken into consideration.

Comment on § 104 :

There is a real concern in the possibility to apply the monitoring tools based on "*Concentration of funding*". Indeed, some problems do exist with respect to the possibility of identifying the actual funding counterparty for many types of debt (CPs or Bonds). As it is also recognized in the Basel Committee paper itself, it is not always possible to identify the counterparty holding the debt and this holds true in particular for institutions that fund themselves principally on the capital markets.