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The Director General delegate

Paris, April 16th 2010

FBF comments on the consultative documents published by the Basel Committee on Banking Supervision (BCBS 164 &165)

Dear Sirs,

On behalf of Baudoin Prot, chairman of the FBF and general manager of BNPParibas, Jean-Paul Chifflet, general manager of Credit Agricole S.A, Frederic Oudea Chairman and chief executive officer of Société Générale, François Perol, general manager of BPCE, and Etienne Pflimlin, chairman of Credit Mutuel, members of the executive committee of the French Banking Federation, I am pleased to take this opportunity to comment on the proposals of the Basel Committee to strengthen the resilience of the banking sector (BCBS 164) and to improve liquidity risk measurement, standards and monitoring (BCBS 165).

The FBF welcomes the initiatives taken by the Committee to strengthen the Basel II framework to promote a more resilient banking sector and to develop an internationally consistent regulatory framework for liquidity risk supervision.

The stakes involved in this reform are considerable, not only for the banking sector and the stability of the financial markets, but also for the economy as a whole. The set of measures that will be finally adopted at the end of 2010 should in fact reconcile several imperatives. The first aim is to strengthen prudential supervision, while maintaining a financial system and a banking industry able to support a robust and sustained recovery, and therefore a fall in unemployment. The markets and banks must also be able to play their role of financing the economy so that Governments and central banks can implement exit strategies and turn around their public finances.

It is vital to select the measures that are truly effective in terms of financial stability from the many measures proposed, and amend or abandon the others. The priorities (although other important issues are addressed in the attachment) are:

.../...

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- ⇒ A much more realistic definition of liquidity ratios.
- ⇒ Limiting the use of the leverage ratio to Basel Pillar 2.
- ⇒ Amendments to the proposed risk-based capital deductions, particularly those applicable to minority interests, insurance companies and deferred tax assets.
- ⇒ The complete revision of the so-called "CVA" technical measure, whose impact as it stands would be as significant as that of all the other measures put together.

It above all suggests safeguarding the economy's interests through impact studies and taking these into account in the calibration of measures: excessive capital and liquidity requirements would bring the economic recovery to a screeching halt.

We also require the Basel Committee to undertake another impact study, once the proposals are adopted, and to assess the cumulative impact of the measures not only on banks but on the whole economy.

We also insist on a progressive implementation of the rules as financial conditions improve and economic recovery is assured, with the aim of implementation by end-2012 in all countries.

As central players in the financing of the economy and the market's operation, French banks therefore wish to actively participate in discussions on the content of this reform, particularly by maintaining close coordination with the public authorities represented in the decision-making bodies.

The French Banking Federation wants to see the instigation of healthy competitive conditions and believes the only way to do so is to establish appropriate regulations. The FBF remains at your disposal for any further discussion on these matters.

Sincerely yours,



Pierre de Lauzun

You will find in the attached annexes:

- *our general comments*
- *our detailed comments on BCBS 164- resilience*
- *our detailed comments on BCBS 165 - liquidity*

Reforming of prudential rules
Position of French banks with regard to current proposals
General comments

Summary

Under the impetus of the G20, the Basel Committee began a complete revision of the prudential framework applicable to banks. This revision process started last summer with a paper on enhancements to market risks and continued in December with the publication of two consultative documents issued for public comments on capital requirements and liquidity risk management. Other works are planned in 2010 on impact studies, measure calibration and potential additional measures.

The stakes involved in this reform are considerable, not only for the banking sector and the stability of the financial markets, but also for the economy as a whole. The set of measures that will be finally adopted at the end of 2010 should in fact reconcile several imperatives. The first aim is to strengthen prudential supervision, while maintaining a financial system and a banking industry able to support a robust and sustained recovery, and therefore a fall in unemployment. The markets and banks must also be able to play their role of financing the economy so that Governments and central banks can implement exit strategies and turn around their public finances.

The impact of the Eurozone Economy of the Basel Committee Proposals has been conducted by French economists and leads to the following conclusion:

- Assuming an immediate and strict implementation of these two proposed standards, Eurozone credit institutions would face (at the aggregate level):
 - a 40% shortfall in their capital ratio, resulting into a €360bn deficit in core Tier 1 capital (under the assumption that investors would keep unchanged their target capital ratio requirements, and excluding the proposed capital charge for mark-to-market losses due to credit value adjustments) ;
 - a shortage of stable funding estimated between €2trn and €3.5trn (depending on the required funding factor assigned to the “remaining assets”, especially financial derivatives with a positive mark-to-market value).

The main findings of this impact study are attached.

As central players in the financing of the economy and the market's operation, French banks therefore wish to actively participate in discussions on the content of this reform, particularly by maintaining close coordination with the public authorities represented in the decision-making bodies. French cooperative banks specify they have sent a full answer about the

application of the criteria on cooperative banks through “Groupement National de la Coopération” (GNC).

With this in mind, the purpose of this document is to present our analysis of the measures proposed and their impact, if they were all implemented, and to suggest amendments to the Basel Committee's proposals.

The first part of this document provides information on the impact of the measures on French banks. These show that as matters stand, the measures proposed would have a disproportionate impact, incompatible with what the sector is able to absorb without jeopardising its ability to finance the economy:

- ⇒ For French banks, the liquidity ratios would require the raising of non market absorbable amounts of medium-term debt.
- ⇒ For French banks, the capital adequacy rules would impose the raising of very large additional amount of capital. The worst case scenario would request French banks to build up another equivalent amount of the Core Tier 1 capital that they have raised or accumulated since their creation within a very short timeframe.

The second part consequently suggests which of the Basel proposals should be given priority: it is vital to select the measures that are truly effective in terms of financial stability from the many measures proposed, and amend or abandon the others. The priorities (although other important issues are addressed in the attachment) are:

- ⇒ A more realistic definition of liquidity ratios.
- ⇒ The limiting of the leverage ratio to Basel Pillar 2.
- ⇒ Amendments to the proposed risk-based capital deductions, particularly those applicable to minority interests, insurance companies and deferred tax assets.
- ⇒ The complete revision of the so-called "CVA" technical measure, whose impact as it stands would be as significant as that of all the other measures.

Finally, the third part will look at the priorities in terms of impact studies and calibration, with a view to the Basel Committee's upcoming works.

Given the above, the document suggests abandoning requirements proposed in addition to these measures, as they are based on concepts that are particularly vague and debatable: countercyclical capital buffers and macroprudential overlays. The Industry clearly favors building up available reserves through prospective provisions, the main obstacle, so far, being their acceptability by the accounting standards setters.

It above all suggests safeguarding the economy's interests through impact studies and taking these into account in the calibration of measures: excessive capital and liquidity requirements would bring the economic recovery to a screeching halt. The impact of the measures cannot be fully assessed until more clarity is brought on the critical subject of calibration. In this regard, French banks would consider it unduly penalising if both capital requirements were to

be substantially increased through better capture of risks and minimum prudential ratios significantly raised at the same time.

Considering that the on going QIS should not only contribute to the determination of the first tentative calibration but also to choosing among multiple alternative rules and eventually to reviewing some ill conceived propositions, the French banks believe it indispensable to plan a second round of consultation, probably in the autumn, in order to fully assess the likely impact on the Industry and on the economy as well as to fine tune any remaining inadequacies in the supervisory proposals.

French Banks do share the concern expressed by the Basel committee that the timing of the implementation of the proposed measures should be set in order not to jeopardise the economic recovery process. Given this important objective, it remains in our view to be demonstrated whether end 2012 is the appropriate target date for a full implementation of the revised framework. Careful consideration should be given to the fact that banks will need to raise liquidity or equity or take decision in respect of balance sheet management well in advance of the target date, i.e. potentially in the critical phase of exit from the current economic crisis. It is therefore of utmost importance that no final decision be taken in respect of the implementation date(s) before comprehensive macroeconomic studies can be conducted to assess the impact of the measures on the return to economic growth in the various regions.

Finally, we would like also to emphasise that French banks remain very mindful of the level playing field principle, not only in terms of the definition but also in terms of its implementation of the revised framework (including avoiding grandfathering clauses that would result into counterproductive distortions between banks or jurisdictions). This issue of level playing field is particularly critical as regards the actual application of the revised framework in the United States vs. Europe. The primary objective of improving the resilience of the banking industry as a whole cannot be achieved unless the revised framework is applied consistently and simultaneously across the major financial markets.

1. The calculated impact of the measures proposed as they stand is much greater than the banks, the economy and the markets are able to withstand.

a. The revising of the capital adequacy ratio rules implies very large capital requirements to maintain current ratios

The proposals of the Basel Committee amend the rules for calculating the capital adequacy ratio:

- ⇒ In terms of the numerator, the definition of risk-based capital is made more restrictive (reduction of Core Tier 1 ratio).
- ⇒ In terms of the denominator, the risk-weighting of balance sheet assets is increased (increase in "risk-weighted assets").

The figures incorporating the impact of these measures have been calculated for the top 5 French banks. As things stand, and leaving aside the specific "CVA" measure (see below), this revision of the calculation would be equivalent to **halving the current ratios**:

In absolute figures, to offset this fall in their Core Tier 1 ratio, French banks would have to **raise very significant amount of additional capital** (compared with Core Tier 1 capital) that would probably not be accepted by the market because of the subsequent dilution and fall of the return under the usual expectations.

This impact does not include the measure proposed by the Basel Committee regarding **Credit Value Adjustments**. This apparently technical and fairly complex issue has a disproportionate impact: this measure alone would cost French banks a very large **additional amount of capital** (almost as much as all of the other measures).

b. The liquidity rules would imply raising medium term debt amounts that are unrealistic in the known market conditions

The Basel paper introduces two supervisory ratios:

- ⇒ a short-term ratio known as the **Liquidity Coverage Ratio (LCR)** aimed at obliging banks to constantly maintain sufficient liquid assets to withstand an acute crisis for 30 days.
- ⇒ a one year ratio known as the **Net Stable Funding Ratio (NSFR)** that compares the available amount of stable funding with the required amount of stable funding.

According to the calculations made for the top 5 French banks, the second ratio (NSFR), as it is currently defined, would imply **raising a huge amount of funding in the medium-term**.

c. The Leverage Ratio produces a figure of around 1% and seems to be of little use to the supervisors

The Basel paper provides a definition of the leverage ratio, with two variations depending on the numerator used either the Core Tier 1 ratio or the Tier 1 ratio.

According to this definition, the average ratio for French banks totals around **1.1% in the first instance and around 1.5% in the second instance**. It is difficult to see how these figures could be of use to the market or even the regulator. On the other hand, any arbitrary requirement to raise this ratio would clearly lead to considerable additional capital requirements (or more likely a **reduction of loans** to reduce balance sheets).

2. Focus on the most questionable proposed measures

a. Priority amendments to the definition of the capital adequacy ratio

The objectives aimed at by the Basel Committee, i.e. a uniform and consistent definition of capital and more effective consideration of market and counterparty risks, must be upheld.

To this end, **the French banks are supporting a large number of the measures proposed** by the Basel Committee: the reinforcement of (market and counterparty) Risk-Weighted Assets (RWA) (subject to the amendments described below), the deduction of risk-based capital from unrealised capital losses, goodwill and assets linked to pension plans, etc.

On the other hand, several amendments are vital, both to limit the unwithstandable impact of the measures proposed and to make them more relevant from a technical viewpoint. The priorities are as follows (detailed comments in the annex attached):

- ⇒ **Minority interests:** the deduction of minority interests from the Predominant Tier 1 capital is only possible if the RWAs corresponding to the minority interests' share are equally deducted from the Predominant Tier 1 ratio's denominator. It is logical (and legally applicable) to consider that minority interests assume their share of the risk borne by the subsidiaries in which they have invested. Equivalent methods are possible involving simply earmarking the amount to be deducted (see detailed comments in the annex attached).
- ⇒ **DTAs:** the deduction of deferred tax assets is only justified for part of these assets. This would mean, for instance, only considering a deduction above a threshold expressed as a percentage of Tier One capital (see detailed comments in the annex attached).
- ⇒ **Insurance:** we consider the proposals of the Basel Committee, which call the existing framework into question and impose an inappropriate deduction from Core Tier 1 capital, to be completely unacceptable. Remember that the issue of double counting of capital is already dealt with in Europe through regulations on financial conglomerates (see detailed comments in the annex attached).
- ⇒ **CVAs:** the measure proposed has a completely disproportionate impact, while overlapping with other provisions. These value adjustments already directly alter the capital, through the profit and loss account, and have the same protective aim as the capital required to cover counterparty risk. Imposing a specific charge for CVA variations necessarily leads to redundancies that should be avoided. This issue should be completely reworked by the Basel Committee (see detailed comments in the annex attached).

b. Priority amendments to liquidity ratios

French banks support stricter supervision of liquidity risks: the reckless risk-taking and excessive maturity transformation of some players were a major cause of the crisis.

The two ratios proposed, however, have two major failings.

- ⇒ The approach, consisting of basing this rule above all on two ratios defined in the same way for all players, is debatable. The rule should rely more on advanced approaches, reviewed by the supervisors, which firstly would take into account the specific characteristics of the various banking models more effectively, and secondly would favour better measuring and better supervision of liquidity risks.
- ⇒ The ratios proposed are defined using an excessively conservative approach, both in terms of sources of funding and the forecast funding required.

If the principle of general ratios, rather than a rule based on advanced approaches, was still preferred, it would be all the more vital to amend the definition of the two ratios, with the following priorities:

i. Short-term ratio (LCR)

- ⇒ Liquid assets: their definition must be widened. Specifically, it is unreasonable in a situation of systemic crisis to work under the assumption that central bank-eligible assets are no longer liquid. This property is the very essence of their liquidity; it is not inconceivable for the markets to close in the event of massive and concomitant sales of government securities. Similarly, it is completely unwarranted to rule out asset classes that remained liquid throughout the last crisis (equities). The exclusion in principle of instruments issued by financial institutions denies the possibility of the existence of an inter-bank market.
- ⇒ Cash outflow assumptions: these must be reviewed in greater detail as they are too conservative as they stand.

ii. Medium-term ratio (NSFR)

The definition of this ratio is particularly excessive in its conservatism, as is shown by the impact analysis. By setting the ratio between sources of funding with a maturity of more than 1 year and funding needs lasting more than 1 year at 100%, the Committee is already introducing a major change in the very role of the banking sector, whose traditional role has always been one of maturity transformation. This is therefore tantamount to reacting to the excessive transformation observed during the crisis by completely banning transformation, which is excessive.

However, according to the definitions adopted, the ratio proposed goes even further: assuming that funding needs lasting less one year will be automatically renewed and therefore included in the calculation of the required amount of stable funding, banks will in fact be performing a reverse transformation (i.e. lending over a longer term than they borrow): such a provision negates the very purpose of banks and poses a major threat to economies where bank intermediation is the main driver of financing.

It is therefore vital to review the definition of this ratio in line with the proposals in the annex attached.

Finally, it is crucial that the rules are applied at consolidated group level rather than per subsidiary, to maintain the possibility of optimum capital allocation and not go back on the very principles of free circulation of capital.

c. Maintaining opposition to the leverage ratio, particularly in Pillar 1

The definition proposed by the Basel Committee is probably the least harmful possible, as by including gross off-balance sheet items and prohibiting the netting of derivative positions, it prevents the distortion of competition with the US and the risk of regulatory arbitrage.

Nevertheless, this ratio serves no purpose from a prudential viewpoint and could incite banks to greatly reduce their loans to the economy if precise targets were given.

It is therefore essential, aside from reiterating the criticisms of this ratio, to absolutely avoid its migration to Pillar 1 of the Basel regulations. In actual fact, such a change would simply be aimed at justifying a substitution for the capital adequacy ratio and would therefore undermine the whole construction of the Basel 2 framework.

3. The scope of these measures calls for the abandoning of additional overlays and reasonable calibration

a. The concepts of "countercyclical buffers" and "macroprudential overlays" are unjustified and excessive

i. Countercyclical buffers

The December 2009 paper introduces the as yet unclarified concept of countercyclical buffers.

The idea is to protect banks against variations in their capital requirements and to allow the supervisors to restrict banks in the use of their profits to build up a "capital buffer" and maintain their ability to keep to their minimum ratios in times of trouble.

This idea is vague in its justification, its objectives and its principles. The procyclicality of capital requirements has not been proven, particularly when applying properly the Basel Committee's framework. This measure comes on top of an unprecedented increase in regulatory minimum requirements. It is completely utopian, as neither the regulators nor the markets would accept the fall of capital adequacy ratios in times of crisis. Finally, the intervening of the regulator in the free disposal of a company's profits poses many problems in terms of principles and rights.

We are calling for the abandoning of this idea and instead recommend booking real forward-looking provisions based on expected loss

ii. Macroprudential overlays

The FSB and the Basel Committee are continuing to work on the idea of additional layers of capital for "systemic" institutions.

We believe that this provision would be harmful as it would promote regulatory arbitrage (some institutions would be less regulated than others with identical activities) and would be excessive given the scope of the planned strengthening of capital requirements. Healthy institutions that observe the strengthened capital and management rules cannot create a systemic risk in themselves. This risk is presented by interlocking systems (such as clearing systems) and global supervision structures. Many initiatives have already been taken to this end. These must be promoted and particular attention must be paid to instances of excessive influence over the markets (dominant position in a single direction), which is a key factor in destabilisation. It would therefore be far more effective to create a reliable and comprehensive observatory of the positions taken by market players, in order to avoid unmanageable imbalances, than to try to penalise still further institutions that are "too big to fail".

b. The impact studies and calibration must take into account the economic interest

Aside from the proposed amendments to the Basel Committee's draft measures, it is important that the public authorities ensure that the impact studies take full account of the consequences of the measures proposed for the economy as a whole.

Given the considerable strengthening by banks of their capital bases in 2009, the measures should be calibrated to consolidate the strengthening achieved, rather than to produce a new wave of increases in capital requirements.

The effects of such an approach could in fact only be absorbed through additional fund raising (the market's depth is limited and capital investors require a return on investment that it would be difficult to provide under the proposed rules as they stand), as well as by reducing balance sheets, and particularly loan outstandings.

The same conclusion may be drawn for liquidity requirements, as the long-term funding required as a result of the proposals could not be absorbed by the markets, the more so as the unfavourable treatment of bonds, particularly for bank issuers, would restrict liquidity and therefore the bond market's depth.

Impact on the Eurozone Economy of the Basel Committee Proposals

Introduction and Summary

- A Group of French economists has focused on the impact of two of the new proposed standards: the revised Tier 1 Capital Ratio and the new Net Stable Funding Ratio (NSFR).
- Assuming an immediate and strict implementation of these two proposed standards, Eurozone credit institutions would face (at the aggregate level):
 - a 40% shortfall in their capital ratio, resulting into a €360bn deficit in core Tier 1 capital (under the assumption that investors would keep unchanged their target capital ratio requirements, and excluding the proposed capital charge for mark-to-market losses due to credit value adjustments) ;
 - a shortage of stable funding estimated between €2trn and €3.5trn (depending on the required funding factor assigned to the “remaining assets”, especially financial derivatives with a positive mark-to-market value).
- Since banks would not be able to raise such massive amounts of capital (common shares) and medium-to-long term debt, loans to the nonfinancial sector would become not only costlier but also and foremost much scarcer. This contraction in bank credit supply would result into a negative cumulative impact on the Eurozone real GDP estimated at 1.5% in the short term and above 6% in the longer term (relative to a “no regulatory change” baseline scenario).
- The timing of this regulatory change would be particularly inappropriate if implemented when the economic outlook in the Eurozone is still weak and frail. It would significantly increase the risk of a L-shaped recovery, relative to the U-shaped recovery currently forecast by the consensus. Note also that government debt can no longer be used to compensate a crunch in bank credit supply, since fiscal policies are already on an unsustainable path in most Eurozone countries and have to be drastically adjusted over the next coming years.
- The Working Group has not assessed the impact of these regulatory changes on the US economy. However, this impact is likely to be significantly milder in the US than in the Eurozone for at least two reasons: (i) the Basel Committee proposals would not apply to the whole US banking system but only to the so called “core banks”; (ii) the nonfinancial sector is much less dependent upon bank credit in the US than in the Eurozone (bank loans amount to less than 50% of GDP in the US, against to close to 130% of GDP in the Eurozone).

Estimating the capital shortfall

- On the basis of brokers' bottom-up research on panels of European banks, we estimate that the proposed rules would cut the average core Tier 1 ratio to 5% from 8.5% (2009 data). In other words, the capital adequacy ratio would be reduced by 40%. Note that this estimate excludes the proposed capital charge for mark-to-market losses due to credit value adjustments (CVA), which would further reduce the capital ratio.
- By extrapolating sample estimates to the aggregated balance sheet of Eurozone credit institutions, we obtain a core Tier 1 capital shortfall of €360bn if banks maintain unchanged their target ratio. This is equivalent to the total amount of capital raised since the beginning of the financial crisis, but whose a substantial part took the form of hybrid instruments.

Estimating the stable funding shortfall

- In order to estimate the “available stable funding” (ASF) and the “required stable funding” (RSF) of Eurozone credit institutions, we have used the aggregated balance sheet data published by the ECB (supplemented by some other sources to get more detailed information). According to the latest data, the aggregated balance sheet of Eurozone credit institutions was close to €30 000bn in January 2010. We have also estimated from other sources off-balance sheet obligations (undrawn amount of committed credit and liquidity facilities).
- In these aggregated data, the main source of uncertainty comes from the lines “remaining assets” and “remaining liabilities”, which amount to about 10% of the total balance sheet. They are residual categories which include financial derivatives and encumbered securities. On the ASF side, we have assigned a 0% factor to all the “remaining liabilities”. On the RSF side, we have produced estimates under two different hypotheses:
 - under the 1st hypothesis (H1), we have assigned a 0% RSF factor to all the “remaining assets”; remaining assets and liabilities have then a neutral impact on the NSFR;
 - under the 2nd hypothesis (H2), we have assigned a 100% RSF factor to half of the “remaining assets” (and 0% to the other half); this increases the required stable funding by a very substantial amount (€1 300bn).

Eurozone Credit Institutions (aggregated balance sheet)

		Hyp. 1	Hyp. 2
Required stable funding (in €bn)	(1)	16560	17860
Available stable funding (in €bn)	(2)	14460	14460
Stable funding deficit (in €bn)	(1)-(2)	2100	3400
Net stable funding ratio (%)	(2)/(1)	87%	81%

- As detailed in the above table, the aggregated stable funding deficit of Eurozone banks is estimated at close to €3 500bn if we assume that part of the “remaining assets” (including financial derivatives with a positive mark-to-market value) require stable funding, and at just above €2 000bn if we do not.
- This deficit in stable funding is considerable. For the sake of comparison, the outstanding amount of debt securities issued by Eurozone banks with a maturity exceeding one year is currently worth €4 500bn. This amount would thus have to be increased by a percentage between 45% and 75%, triggering a steepening in the yield curve at the macro level. Note also that banks will not be able to fully substitute medium-to-long term debt to short-term debt: outstanding bank debt securities with a maturity below one year amount to less than €1bn. However, if medium-to-long term debt issuance substitutes to other sources of stable funding, the impact on the NSFR would be much reduced. For instance, if 1€ of debt issuance is funded, at the macro level, by a decline of 1€ in deposits (70% weighted if “less stable”), the available stable funding will increase by only 30 cents.
- It would be not only very costly but also very difficult for banks to issue such amounts of medium-to-long term debt. As a consequence, they would also have to cut their lending. Note however that the *ex post* decline in loans would have been very large. Since at the macro level loans create deposits, the reverse process would shrink deposits and thus available stable funding (through a sort of reverse credit multiplier mechanism).
- On the asset side, banks would also have a strong incentive to substitute government bonds and –in a lesser extent- nonfinancial corporate bonds to loans. SMEs, which are very dependent upon bank loans, would be the most severely impacted.

Assessing the impact on the Eurozone real GDP

- In order to assess the impact of these regulatory changes on the economy, we have used models incorporating a bank lending channel of transmission, distinct from the traditional interest rate channel. The specific role of bank lending has two causes:
 - on the banking sector’s side: imperfect substitutability among their liabilities;
 - on the nonfinancial sector’s side: imperfect substitutability between bank loans and debt securities.
- Indeed, we have applied a two-step approach, similar to the one used by the European Commission¹ and the IMF² to quantify the impact on Eurozone GDP of subprime related losses:
 - in the first step, we estimate the impact of the capital and stable funding shortages on bank credit supply to the nonfinancial sector ;
 - in the second step, we estimate the impact of this credit supply shrinkage on real GDP³.

¹ European Commission : « *Quarterly Report on the Euro Area* », p26-31, N°4 (2008).

² IMF Working Paper # 69 (2009): “*From subprime loans to subprime growth? Evidence for the euro area*”.

- In the first step, we estimate that the proposed regulatory changes would translate into a 20% in bank loan supply (relative to baseline). In the second step, this results into a negative impact on the Eurozone GDP close to 1.5% in the short term and cumulating to nearly 6.5% in the longer term.
- These estimates are of course subject to many assumptions, and must be interpreted very carefully. Nevertheless, they show that an immediate and strict application of the proposed regulatory standards could significantly put at risk the economic recovery in the Eurozone.

³ We have relied on the elasticities calculated by ECB's economists Cappiello-Kadaraja-Sorensen-Protopapa in : « *Do Bank Loans and Credit Standards have an Effect on Output? A Panel Approach for the Euro Area* », ECB Working Paper Series, N°1150 (2010). According to this study, a 10% decrease in bank credit results into a real GDP decline (relative to the baseline) of 0.8% in the short term and 3.2% in the longer term. Note that these elasticities are smaller than the ones used in the EC study mentioned above in footnote 1.

Detailed comments on BCBS 164 - Resilience

1- Definition of the capital base

Article 76

We note that in paragraph 76 the Committee is considering the treatment of instruments with tax deductible coupons in Additional Going Concern Capital. But we believe that capital recognition should be independent of tax treatment. So long as all of the relevant criteria in relation to loss-absorbency, flexibility of payments and permanence are met, there is no justification in imposing additional restrictions about tax treatment in relation to capital recognition. Doing so would create an unlevel playing field while providing no additional capital support.

Furthermore, harmonisation of the global taxation rules for capital instruments will be virtually impossible. Any forced regulation through the Basel proposals will result in an unfair advantage for some issuers over others. This view has also been reflected in the recent EC CRD IV proposals which make clear that tax should not be a factor when assessing the quality of hybrid instruments.

Article 84

Regarding non Predominant Tier one instruments, the mention of the consultative document publication as starting date for the grandfathering period has created much confusion in the market.

In fact, the new instruments features will be determined in the final Basel text to be published end 2010 or early 2011, and phased in as of end 2012. In the meantime, institutions need to continue issuing new instruments to comply with their Pillar 2 requirements, according to the usual RWA increase.

From a legal point of view, CRD 2 has now become applicable in Europe and provides a grandfathering period starting Dec 31st 2010.

For all these reasons, we urge BCBS to clarify urgently the grandfathering arrangements. We advise that they start when the rules will be applicable (end 2012). This reasonable transition period will leave time enough both to issuers and investors to adapt to the new rules.

Article 85

The European Commission has recently harmonised the rules of capital definition for all EC banks. This includes limits on hybrids, with predominant core capital of a minimum of 50 % and a possibility of having hybrids up to 35 % of total capital before any deduction of banks holdings.

We do support these limits and not see why the percentage of predominant capital should not diverge from these reference levels.

We would like to stress the main features of hybrids issues: flexibility, access to various investors etc... It should be mentioned another positive aspect of hybrids : they allow to issue

capital in foreign currencies which will be necessary to prevent volatility in solvency core tier one ratios due to foreign exchange fluctuations.

Article 87

The approach adopted by the Basel Committee presupposes that the purest capital consists solely of shares that can be traded on the market. This idea overhangs the definition of the 14 criteria which have been elaborated on the basis of the thought that a share that can be traded on a market is, by nature, the ideal and unique form of pure capital, as confirmed by the relegation of cooperatives as a footnote.

The Basel Committee should respect the principle of neutrality between different legal forms and organisational structures, and hence should not weaken cooperative models purely as a result of collateral damage inflicted by definitions based solely on joint stock companies, with no prudential justification. No exception should be made for cooperative capital just because a single and debatable benchmark is used.

-> The 14 criteria:

Without jeopardising the 14 criteria, their implementation must not lead to the hypothesis that, in the end, only shares traded on the market would, by nature, meet their requirements.

Comments are to be made on at least two criteria:

Criterion 2: in the case of liquidation, securities representing the capital must have a right to the net assets in proportion with the capital that they represent (= right to the liquidation surplus).

In the view of the stated objectives in response to the financial crisis, it should be noted that the system used by cooperative companies is more satisfactory from a prudential standpoint than the one envisaged by joint stock companies. Indeed, cooperative shareholders can not lay claim to the company's net assets, which strengthens the financial solidity of cooperative banks (notably in view of the permanency criterion).

Criterion 5: compensation (...) not subject to a ceiling

It seems to be a great paradox if the Basel Committee were to impose the disappearance of remuneration cap, thereby favouring the dispersal of profits to the detriment of the establishment of reserves, while nonetheless defending the establishment of buffers within the same document.

Article 89 + Criterion 7 (a)

We appreciate that the Basel text gives a precise definition of Additional Tier 1 instruments, to be applied in the financial community worldwide.

Nevertheless we would like to draw the attention of the Committee on the fact that the severe restriction of the product's panel will put more pressure on banks who will need to attract new

investors on those new designed products, at the moment where more own funds are needed, while preserving the dynamics and coherence of the current marketplace.

Moreover, to enable banks to switch to the new rules in a smoother fashion, we have identified among the criteria listed in the text some features that might need to be modified or clarified (according to our understanding of the text), compared to the present hybrids market situation:

as said in §2, these instruments are deeply subordinated and we understand that they are only senior to ordinary shares. As a consequence we have identified the following questions:

Criterion 7 (a): the bank must have full discretion at all times to cancel distributions/payments

We think that the definition of “full discretion” should be clarified. In fact, to preserve the ranking of the hybrid holders, dividend pushers should be allowed to ensure that hybrid holders receive a coupon as soon as shareholders receive a dividend.

Article 89, Criterion 8

We are of the opinion that this criterion is unclear given the ranking issues mentioned before for hybrids structured as deeply subordinated debts. Therefore, we would recommend the following wording : “Dividends / Coupons are paid only if there are distributed items(retained earnings included)”.

Article 89, Criterion 11

We strongly support to remove the reference to “classified as liability” to ensure that all instruments recognized in Tier-1 Additional going Concern Capital include this requirement for loss absorption. It is to be noted that the European Commission is also considering removing this distinction (Cf. consultation paper on CRD IV). Such distinction, if maintained would not be rationale from a capital benefit perspective and would create a competitive distortion with US and UK markets practice as preference shares, which have a legal nature of equity, would not be subject to such conversion or write down.

We advocate that this mechanism remains temporary and not permanent. A permanent write down is not acceptable for investors but also conceptually not acceptable as it effectively subordinates Tier-1 Additional Going Concern Capital to Common Equity, while Common Equity must be the most subordinated form of capital according to Basle’s eligibility criteria. It should be clarified that a write up is possible, to preserve the ranking of the instrument, if the situation of the bank improves; otherwise investors in this kind of capital would be worse off than shareholders as these participate in the recovery of a bank when retained earnings are built up again. The same applies in case of liquidation, once all other creditors have all been repaid.

Article 89, Criterion 12

It should be clarified that this criterion aims at discarding financial engineering turning intentionally debt into equity, but does not preclude normal relationship with institutional investors who may have at the same time credit facilities and a portfolio invested in bank's instruments (among other).

Moreover a limit for market making on own instruments should also be granted to enable issuers to have their investment banking arm participate in the liquidity of the instruments that have been brought to the market.

2- Minority interests

The Basel committee proposal on minority interests (page 23) excludes minority interests from the common equity component of Tier one. Although it is not explicit, we assume that minority interests will continue to be fully included in Tier one.

Since a core tier one ratio will become a regulatory ratio, this proposal leads to a situation where a group core tier one ratio integrates 100% RWA of consolidated subsidiaries (denominator) but cannot take into account 100% of consolidated subsidiaries' capital (numerator).

There appears to be no good reason for this imbalance in the prudential treatment of the denominator (RWAs) and the numerator (Minority interests) as minority investors do effectively absorb part of the risks of the subsidiary.

This would have a very large impact on the European market:

- It would penalize the business model of cross-border groups, especially in the context of the EU single market : local authorities sometimes impose for a group not to take control of 100% of a bank in order to have part of the capital owned by local investors or to maintain a meaningful listing on the national stock exchange. In some instances, historically banks were simply not able to acquire 100% of the capital of local banks as only a controlling stake was offered for sale in the privatisation process. Independently of such constraints, it can also be a well devised strategy for banks to share the risks associated with investments in foreign markets by bringing along local investors. Similarly, the terms of successful collaborations between banks and industrial partners often relies on shared ownership of dedicated in order to ensure an alignment of interests. Finally, there are instances where banks may need to incentivise the founders and Management by allowing them to retain minority interest in the capital of a newly acquired company. The proposed deduction will penalize banks in their external growth strategy and/or will change their behaviour in relation to the capitalisation of their subsidiaries. In particular, it may reduce banks' appetite when it comes to contributing direct investments to the modernisation of the banking industry in certain emerging countries including in Europe.

Selected examples of presence of minority interests in certain subsidiaries

Poland

Historically, the Polish FSA (or its predecessor - KNB) required the foreign purchaser of a controlling stake in the capital of a Polish bank to assume certain obligations such as:

1. keeping the bank listed on the Polish Stock Exchange;
2. capping the controlling stake to 75%..

As a result of that constraint, Foreign banks were compelled to maintain significant minority interests in their local Polish subsidiaries, as can be illustrated by the examples of ING and Citibank/

ING / Bank Slaski:

In March 2001, ING was allowed by the FSA to cross the 75% threshold in the capital of Bank Slaski but on the condition that subsequently the stake held by Citibank would be reduced to 75% ; This was achieved in 2005 when ING sold a 12.77% stake in Bank Slaski and thus reduced its holdings to 75%.

Citibank / Bank Handlowy:

In 2000, Citigroup was allowed by the FSA to cross the 75% stake in Bank Handlowy and to merge Bank Handlowy with Citibank Poland, on condition, that within two years from the acquisition, Citigroup would reduce its shareholding to 75%. In December 2004, Citigroup sold an 18.2% stake in Bank Handlowy and thus reduced its stake to 75%

Romania

Société Générale / BRD:

There are significant minority interests alongside Société Générale in the capital of BRD (ca 40%) This results from the fact that when BRD was privatised in 2002 only 47% of the capital was put for sale. Société Générale was thereafter able to increase its stake above 50% thanks to a capital increase but the rest of the capital remains held by a few local institutional investors who do not intend to sale their stake.

Czech Republic

Société Générale / KB:

Although there was no explicit regulatory constraint in respect of the level of foreign ownership in KB, only a controlling block was put for sale and the Government was keen to maintain KB listed on the Czech Stock Exchange given its weight in terms of market capitalisation.

Nederland

BNP Paribas / Insinger de Beaufort:

BNP Paribas acquired ca 63% of the capital while the remaining 37% remained the ownership of the historical founders and management of the acquired company in order to align the interests of the historical management with those of BNP Paribas and to maintain its entrepreneurship component.

France

BNP Paribas / Case New Holland:

BNP Paribas acquired 51% in a newly incorporated French company with remaining ownership held by Case New Holland, a global leading manufacturer in the agricultural and construction equipment businesses. The partnership has existed for 13 years, demonstrating the solid relationship and aligned interests that exist between the two companies. The partnership is active across Europe with established entities in Germany, Austria, Belgium, France, Italy, Netherlands and the United Kingdom.

- it would limit private sector solutions for rescuing ailing banks: if minority interests had not been considered by regulators as part of core tier one, some operations would have probably never happened. This is contradictory with the Commission's objective to build a stronger framework of crisis management in Europe with a more balanced burden-sharing between private and public sectors.

The BNPP/FORTIS case

During the financial crisis, BNP Paribas has negotiated with the Belgian and Luxembourg governments for the acquisition of Fortis Bank and BGL. The complex acquisition would have been more difficult under the newly proposed regime.

Indeed the fact that the shareholders' equity held by the Belgian and Luxembourg States was taken into account as minority interests in Tier-1 while 100% of the RWA were also taken into account in BNP Paribas's ratio was a key ingredient to this complex transaction and a major lever to reach an agreement with the Belgian and Luxembourg States that wanted to remain reference stakeholders.

In order to **achieve a more balanced treatment**, we should **exclude RWA supported by minority interests** from the denominator of the group Core Tier One ratio. For each subsidiary with minority interests, the consolidated RWA of the subsidiary would contribute to the total group's RWA only up to the percentage held by the parent company when calculating the Core Tier One ratio of the Group. The Group core tier one ratio would then reflect in a symmetrical way both the capital held by the Group (ie excluding minority interests) and the risks associated with the subsidiary (ie excluding the portion of RWA assumed by minority shareholders) – see numerical example below (case 2).

Another approach could also consist in the **inclusion of Minority Interest up to a limit in the numerator of group core tier one ratio**. There can be instances where the local subsidiary is capitalised well in excess of the Core Tier One ratio of the group measured on a consolidated basis. In this case, one could argue that the Group unduly benefits from this overcapitalisation through the inclusion of minority interests in the Group's regulatory capital.

To prevent this situation, minority interests in subsidiaries could be included only up to the level corresponding to the Core Tier One ratio of the group. The portion exceeding this threshold would cease to be recognised in Core Tier One capital of the group - see numerical example below (case 3)

Numerical examples for a more balance treatment of minority interests

Assume one Group with only 3 subsidiaries with minority interests (other subsidiaries held 100%¹). The group Tier One capital is 3 000 M, including

¹ for the purpose of the calculation, "mother" will thereafter refer to the parent company consolidated with its 100% subsidiaries.

240 M Minority Interests (MI), 500 M regulatory adjustments and 900 M Non Predominant instruments. The total group's RWAs are 30 000 M, of which 7100 M represents the contribution of the 3 subsidiaries to the consolidated RWAs.

	%ownership MI	cap+ res+ MI	deductions	hybrids	Total T1	RWA
Mother		2 360	-500	900		22 900
Sub1	30%	50				1 000
Sub2	45%	150				1 100
Sub3	10%	40				5 000
Total subsidiaries		240				7 100
Total Group		2 600	-500	900	3 000	30 000

Group Tier One ratio is 10%. If minority interests were fully recognised in the Core Tier One for the purpose of the calculation of the ratio, the Core Tier One ratio would be 7%.

Case 1 / Basel proposal

Minority interests are excluded from predominant capital AND Core Tier One ratio continues to be calculated based on the Consolidated Group's RWAs. Core Tier One capital is therefore 2600-240-500 ie 1860 while the RWA to be taken account in the calculation of the ratio remain unchanged at 30 000.

	Core T1	RWA	Core T1 ratio
Basel Ratio (MI excuded from Core)	1 860	30 000	6,20%

Case 2 : Symmetrical deduction of RWA and Minority Interests

Minority interests are deducted from Core Tier One capital but for symmetry purposes, only the portion of the subsidiaries' RWAs corresponding to the ownership percentage of the group is taken into account in the denominator of the Core Tier One ratio.

$\Sigma \%ownership_i * RWA_i = 1\,295\text{ M} = \text{RWA to be excluded from denominator.}$

	%ownership MI	RWA belonging to MI
Sub1	30%	300
Sub2	45%	495
Sub3	10%	500
Total subsidiaries		1295

	Core T1	RWA	Core T1 ratio
subsidiary's RWA are reduced to the group's percentage	1 860	28 705	6,48%

NB1 : data collected in table 2 of QIS could allow to compute this case.

It is to be noted that Banks could continue as today to report consolidated RWAs (ie including the portion attributable to minority shareholders), in particular for the purpose of the Tier One ratio calculation.

Case 3 : Group Core Tier One ratio adjusted for the “overcapitalisation” of subsidiaries

Minority interests are included in the Group Core Tier One capital but only up to a cap defined by reference to the Mother’s Common equity Ratio (such ratio being defined as per the QIS as (Mother’s capital+ reserves)/ Mother’s RWA = 10,3%).

The “overcapitalisation” of the subsidiary which should be excluded from the calculation of the Core Tier One capital can then be defined as:

$$\text{Overcapitalization Sub}_i = \text{MI}_i - 10.3\% * \text{RWA}_i * \% \text{ ownership MI}_i$$

For instance, in sub 2, the Portion of RWA attributable to minority shareholders is 495 and if the reference Mother’s common equity ratio was applied, the minority interests should be equivalent to 51, hence a 99 “overcapitalisation” compared to the actual amount of minority interest (150). Based on this calculation, the amount of relative “overcapitalization” attributed

	overcap vs Common cap
Sub1	- 19
Sub2	- 99
Sub3	-
Total sub	- 118

to MI can be excluded from Core Tier One capital:

NB 2 : data collected in table 5 of QIS could allow to compute this case.

NB 3 : One can notice that the exclusion of this overcapitalization could also apply for Tier One capital

	Tier one	RWA	T1 ratio
overcap MI based on mother's common equity	2 882	30 000	9,61%
	Core T1	RWA	Core T1 ratio
overcap MI based on mother's common equity	1 982	30 000	6,61%

3- Deferred Tax Asset deduction (paragraph 98)

The consultative document states that deferred tax assets (“DTAs”) that rely on future profitability to be realised should be deducted from the common equity component of Tier 1 capital. We recognise that a degree of prudence may be required when allowing DTAs in

regulatory capital as their value can be affected in periods of economic stress. However, we see little justification for such a draconian deduction, which in our view fails to take into proper consideration the various categories of DTAs as well as the value they retain on a going concern basis.

1. The Committee must appreciate that DTAs result to a large extent from the discrepancies in national tax rules and that in any case the accounting standards make the recognition of all DTAs subject to confirmation by the external auditors.

DTAs dependent upon future profitability to be realised arise both from tax loss carried forward and timing differences between the recognition of gains and losses in financial statement and their recognition for tax computation. Such timing differences commonly derive from the numerous discrepancies between tax and accounting rules, which vary greatly depending on tax laws and jurisdictions. For instance, discretionary or no-name-specific provisions may not be tax deductible in some jurisdictions, thereby creating DTAs that will only reverse when the actual loss is incurred. Inevitably, banks do record significant amounts of DTAs associated with “temporary differences” in their normal course of operations.

In reporting net DTAs companies are required by accounting standards to make an assessment of recoverability based on estimates of future taxable profits. Importantly, this assessment is subject to scrutiny from external auditors in the context of their periodical accounting review, particularly in periods of economic stress: DTAs will not to be recognised (or will be written off in whole or in part if they have been previously recognised) in case there is not enough certainty that taxable profits will be available to support the utilisation of DTAs in future years.

2. We can accept that harmonised rules be defined in order to avoid undue reliance on DTAs in regulatory capital but consider that the proposed blanket rule deduction is unwarranted and will entail undesired effects.

We do understand the concern about the undue reliance on DTAs that can be derived from lessons learnt during the Japanese banking crisis of the 1990s. The introduction of an internationally accepted rule for DTAs allowance in regulatory capital could therefore be useful to avoid this type of situation. We are also cognisant of the fact that DTAs are commonly recorded based on their nominal and not time-discounted value. However, we strongly urge the Committee to revisit the blanket rule deduction envisaged which is not only unwarranted but could also have undesirable effects:

- **The logic underlying the proposed deduction, i.e. that DTAs dependent on future profitability should hold no value at all whatever the circumstances, does not appear coherent with the “going concern” approach adopted by the Basel Committee for Tier 1 capital.** As explained earlier, DTAs are already subject to an economic value test conducted by external auditors to confirm their recoverability. Actually, DTAs, do retain value over the long term as long as the bank is in operation. This is even true for the part that has not been recognised since the time limit set by tax authorities to utilise DTAs is usually very long or unlimited. It is only in a liquidation scenario that DTAs will lose entirely their value, at least in most tax jurisdictions and from that perspective a deduction from Tier 2 rather than Tier 1 capital could even appear defensible. Evidence that DTAs, whether that be on tax losses carried forward or timing differences, do retain value in periods of stress is supported by the fact that DTAs will be fully factored in when conducting a valuation of the business in case the bank or one of its subsidiaries is acquired or transferred.

- **Clearly, the proposed deduction increases the pro-cyclicality of the capital regime.** DTAs resulting from tax losses, loan loss reserves (not always tax deductible) and unrealised investment losses will increase during downturns and be reversed when results improve. As a consequence, the proposed deduction will further deplete capital in periods of economic stress.
- **The forward-looking provisioning scheme advocated by the Basel committee will translate into non tax-deductible provisions thereby increasing substantially the amount of DTAs.** Deducting such DTAs from Tier One Capital would annihilate in part the benefit of this countercyclical measure and may even disincentivise conservative provisioning policy.
- **The proposed deduction is in part contradictory with the stated objective to maintain a level playing field.** The proportion of DTAs resulting from temporary differences varies widely between countries depending upon local tax laws. Deducting such DTAs penalise banks operating in tax jurisdiction where certain asset value adjustments (e.g. loan loss reserves, impairment, write down) are not tax deductible and this will translate into undesirable distortions based on the localisation of a bank's activities.

3. We recommend that the Committee devise a more balanced partial deduction rule, taking into proper consideration the different categories of DTAs.

We ask the Committee to give consideration to a more balanced approach for DTAs:

- a. Based on the partial deduction rule principle already accepted by some bank supervisors:** capping the amount of DTAs that can be recognised for prudential purposes would address the concern about excessive reliance on DTAs while recognising that DTAs do retain value on a going concern in most circumstances. It would also alleviate the procyclical effect of the measure. We think that in the context of prudential supervision, a cap expressed as a percentage of capital would be more straightforward and effective than a limit based on a set time horizon².
- b. Based on an important distinction to be made between tax loss carried forwards and timing differences.** The Committee must take into account that the level of timing differences, contrary to tax loss carried forwards, can be heavily influenced by the tax regimes in the jurisdiction where the banks operate. Furthermore, banks record a permanent cushion of timing differences which are very likely to reverse normally in most circumstances. Applying a permanent deduction for such DTAs would be unduly penalising. Admittedly, where a bank starts making a loss and record a Tax Loss Carried Forward, more convincing evidence will be required that sufficient future taxable profit will be available for such tax losses to be utilised. For those reasons, no

² A maximum time horizon for DTAs recognition in regulatory capital could involve the presentation of tax business plans on a regular basis and for several entities within the Group (i.e for each domestic and foreign tax entity within the Group as assessing recoverability of DTAs based consolidated financial information is irrelevant). The suitable time horizon can also vary depending upon the business mix of the entity and the reliability of forward looking estimates.

deduction should be apply for DTAs on timing differences while a cap may be required for DTAs on tax loss carried forward.

Following that logic, we recommend that:

- **No deduction should apply to DTAs on timing differences;**
- **DTAs on tax loss carried forward should only be deducted from the Common equity component of Tier 1 capital in all or in part where the total amount of DTAs exceeds a certain threshold of Tier 1 capital (for instance 10%³) as illustrated by the example below:**

	Net DTAs arising from Timing differences In % of Tier One Capital	DTAs arising from Tax loss carried forward In % of Tier One Capital	Total Net DTAs In % of Tier One Capital	Portion to be deducted from Predominant Tier One
Case N°1	9%	9%	18%	8%
Case N°2	12%	5%	17%	5%
Case N°3	4%	6%	10%	0%

Finally DTAs generated on elements that are not included in Predominant Tier One capital in the first place cannot be subject to the deduction either. If minority interests are deducted from Predominant Core Tier One capital, DTA deductions on the entities concerned should therefore also be adjusted to the pro-rata of the holding. Besides, DTAs on OCIs (Cash flow hedges) and therefore no contribution to Predominant Tier One capital should not be subject to the deduction.

4- Unrealized gains and losses on debt instruments, loans and receivables and equities

We believe it should be made clear that the proposed rule only applies to gains and losses recognized in equity and not to unrealised gains and losses accounted in net income.

For unrealised losses recognised in equity, we agree no filter should be used in the future to reinforce the quality of the capital base.

For unrealised gains on equity instruments, equity investments that will continue to be accounted with unrealised gains in equity under IFRS 9 will be long term investments. There will indeed be no rationale for developing short term or medium term activities with

³ Such % being set – potentially at a higher level- when all consequences of the proposed BCBS measures can be evaluated.

unrealised gains recognised in equity under the new standard as banks “*will have to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument*” meaning that, if the investment is sold, the profit would no longer be recognised in net income.

As unrealised gains generally apply to strategic equity investments and as this will be strongly reinforced by the new accounting standard, it would really be appropriate to take part of the growth of the value of the investments for the calculation of the own funds of the bank: for example, if a bank buying a stock of 100 and this investment has after 20 years of holdings a value of 300, it does not seem realistic to base the value of the investment on the original value of the investment for its capital base (numerator). It may be advisable to apply a haircut to the value of the investment (in Belgium 20 % and in France even 55 % currently applies) and to consider the unrealised gains in the Tier two, but to fully filter unrealised gains whereas on the other side capital losses are deducted at 100 % from tier one clearly does not make sense.

The unrealised gains on debt instruments are for their part not accounted in equity under IFRS 9.

We would however recommend that the Basel Committee waits for US GAAP and IFRS amendments and transition provisions on financial instruments to be fully finalised before implementing the new rules on unrealised gains and losses. This would prevent unwanted swings in the capital base triggered by changes in accounting standards. On this matter we would also like to stress that in order to reduce the need for prudential filters, it is crucial that accounting standards allow for a proper consideration of the actual business model of financial institutions and do not introduce artificial volatility in equity.

5- Deduction of own shares

FBF disagrees with the « non-netting » of short positions involving counterparty risk. It does not make sense to mix considerations on counterparty risk (captured through RWAs) with the calculation of the net position on own funds. The requirement proposed by the Basel Committee that gross long positions may be deducted net of short positions only if the short positions involve “no” counterparty risk is unrealistic and probably impossible to attain on a meaningful basis. The resulting capital requirements would be totally disproportionate and unrelated to the actual risk.

In that respect, the “look through” requirement for holdings of index securities participates to the adequate netting of exposure. However, an exemption granted by the supervisor, should be envisaged for banks holding such indexes on a marginal basis and for general banking book hedging purposes.

6-Participations in financial institutions

FBF disagrees with the « non-netting » of short positions involving counterparty risk on the same grounds as those in the prior § on deduction of own shares.

Identically, the “look through” requirement for holdings of index securities participates to the adequate netting of exposure. However, an exemption granted by the supervisor should be envisaged for banks holding such indexes on a marginal basis and for general banking book hedging purposes.

Additionally, FBF believes that there should be no deduction of holdings in market place organisations as they are pure operating structures required for a proper functioning of the market place.

Furthermore, ancillary banking services undertakings should not be deducted and rather risk-weighted as other assets (100%).

7-Participations in insurance companies

With respect to the deduction of the participations in financial institutions, we urge to restrict the scope of this deduction to discard insurance companies. The full deduction is not the right answer to participations in insurance companies.

Banking and insurance groups: an integrated successful business model but with different risk types and horizons

First of all, it should be mentioned that substantial holdings in insurance companies allow banking groups to significantly enlarge the range of products they are offering to their customers, at a competitive price, through a common distribution channel. Thanks to the durable partnership that exists between banking and insurance activities, the “bancassurance model is a very strong one.

However, risks borne by insurance companies are of different nature compared to the banking risks. In the insurance sector, the main risks are composed of (i) underwriting risks (insurers predict the likelihood that a claim will be made against their policies and they price their products accordingly) and (ii) asset management risks (companies have to ensure that the premiums and life insurance deposits they receive are invested in an appropriate way). The requirements on investments are also different, in particular since the insurance investment period is typically very long-term. Banks and insurance companies are therefore regulated by specific regulatory requirements: in Europe, banks must comply with the Basel 2 prudential requirements, known as the Capital Requirements Directive (CRD) in the EU, while insurance companies are subject to the Solvency 1 and tomorrow the Solvency 2 directives.

Avoiding Double counting: the conglomerate approach

The issue of potential double counting effects of own funds between banks and insurance companies has been identified in the late ‘90s by the Joint Forum (a working group of the BSBC, IOSCO and the IAIS) which has established the roots for the consolidated supervision of mixed financial companies and has proposed “*measurement techniques and principles to facilitate the assessment of capital adequacy on a group-wide basis*”.

In the EU, these recommendations were translated into the Financial Conglomerate Directive (EC 2002/87) in 2002. This global framework has now been operational for several years in all EU countries and has strongly proved its efficiency during the recent crisis.

The absence of double counting is analysed on the one hand at a global level (conglomerate ratio) and on the other hand at the banking and insurance level respectively.

Indeed, the way the conglomerate directive may be applied following the methods proposed by the Joint Forum, as it is the case in France, correctly takes into consideration this consolidated approach as follows:

- a global control of the solvency of the conglomerate through the calculation of an “observation ratio”. The latter is produced by adding up the requirements of the banking activities and those of the insurance group and by comparing this amount to the consolidated total capital of the group (intra-group transactions being eliminated) to ensure that the requirements are fully covered ;

- for the bank solvency calculation, including :

 - * deductions from the core tier one for the goodwill relating to insurance purchases ;

 - * deductions from tier one for the part which relates to the double counting in the tier one (i.e. neutralisation of the insurance reserves and elimination of the potential capital gains and losses booked in the insurance companies as they would otherwise also appear as banking capital due to the prudential consolidation methodology which is used) and equity participation risk weighting for any remaining holdings.

It should also be mentioned that this prudential assessment is integrated in an additional stringent European EC framework for all financial groups which have been designated as conglomerates, with more constraints than Basel 2 framework on large exposures, sectorial analyses (equity investments, real estate), internal control issues and a review and elimination of the reciprocal transactions between the banking entity and the insurance one.

This double geared system includes therefore a full monitoring of all the risks taken by financial conglomerates and the careful control of their capital coverage.

In this context :

- We call on regulators to focus in priority on the implementation of Solvency 2 (and its equivalents outside of the EU) and now on the forthcoming Basel 3 framework before any review of the regulation in the conglomerate field.

- We request that no redundancy or interference to the current treatment should be made until the calculation of capital adequacy rules on a conglomerate basis is reviewed and updated globally within the appropriate bodies, ie the Joint Forum.

- More specifically, we recommend that the Basel Committee harmonises the international prudential practices by adopting the procedures of conglomerates which already exist in European groups, in line with the recommendations of the Joint forum.

8-Enhancing Risk Coverage

a. Uncapitalised losses due to Credit Valuation Adjustments (CVAs) during the crisis

Regulators claim that a significant part of the losses due to counterparty risk during the crisis were in fact due to Credit Valuation Adjustments (CVAs) and not to the default of counterparties. Potential losses due to CVAs are currently not capitalised, as this practice is more recent than the counterparty risk capital framework.

What are CVAs?

CVA is the credit price of counterparty risk. On a fair value accounting approach banks should price their derivative products taking into account the credit quality of the counterparty. The idea is to discount from the counterparty portfolio mark to market the expected loss due to a potential default of the counterparty. It is worth to note that CVA is not a market product that could be priced directly in the market..

Current practice around CVAs

Industry practices are still very heterogeneous both in the way bank compute their CVAs and in their managing intent around CVAs.

Whilst some institutions have no CVA framework, most institutions would compute CVAs to comply with IFRS or US GAAP definition of fair value. We would argue that the choice of a CVA framework is an accounting issue, linked to the definition of fair value adopted by each institution (there is no specific prescription within IAS 39 defining the way the CVA must be computed), whilst the managing intent around CVAs should remain the choice of the bank.

Several framework of CVAs co-exist (unilateral, bilateral or mixed approaches) but it is not the purpose of this document to elaborate on these different frameworks.

Banks can also compute CVAs very differently depending on their business model intent. For example, banks willing to hedge this element of their derivatives fair value would tend to compute CVAs using market credit spread so as to be able to hedge themselves in the market. Some banks have a dedicated trading desk to manage their CVAs which they consider to be a trading position like any other position of their trading book.

Other institutions, considering these CVAs as a credit risk that they are willing to carry would tend to compute CVAs principally based on historical probabilities and taking into consideration criteria factors retained by markets participants, as if these CVAs represented a credit position in the banking book.

Some banks can use both methods according to their business segments.

A capital charge depending on the CVA framework and the managing intent

If regulators want to capitalise CVAs as these can affect the bank's results, we strongly believe that this new capital charge should take into account the CVA framework in place so that the capital charge corresponds as much as possible to the real risk incurred by the bank.

We also believe that the capital charge should take into account the business model underlying the management of the CVA position. The same way a bond, dynamically hedged in the trading book, would be marked to market and would attract a market risk charge (now VaR, Stressed VaR and IRC), whilst a bond in the banking book could be valued in accrued and would attract a credit risk charge, the same way CVAs could be valued differently depending on their managing intent and would represent a very different risk for the bank. As a consequence, we believe that the managing intent should be taken into account to decide how to capitalise CVAs.

If a bank decides to mark part of their CVAs to market and hedge them dynamically, these should be considered as a trading book position and their capital charge should address their potential spread volatility when spreads move. With the addition of IRC, the full market risk treatment would then address the potential change of these CVAs due to all market risk factors, as well as the one year risk of credit migration and default. A counterparty risk capital charge for those counterparts would become unnecessary.

If a bank decides to carry part of their CVAs as a pure credit position which depend on historical probabilities, these should be considered as a banking book position and treated according to a credit approach. Their capital charge should take into account the possible change in CVAs due to ratings, looking at the one-year risk of credit migration. The one-year risk of default would be unnecessary as it would be already accounted for in the remaining counterparty risk capital charge.

More on the trading book approach

We recommend that the regulatory capital treatment of portfolios of counterparty risks that are marked to market and managed within a trading book regime be consistent with other similar trading risks.

Specifically, we recommend that the regulatory capital on counterparty risks should be assessed by including the CVA (and all its single-name, credit index and other hedges) in the trading VaR, stressed VaR, and IRC frameworks. In this way, the CVA risks and hedges would be treated as integral parts of the full trading book and would be measured within the full trading book context.

The banking book EPE-based charge should be eliminated for those banks. It is inconsistent with the way that the CVA of those marked-to-market portfolios is managed and redundant with the IRC charge that already capitalizes the impact of default.

More on the banking book approach

On the banking book approach, CVA calculations are mainly driven by counterparty credit quality assessed through ratings. This impact can be broken down into two components:

- The default risk which already adequately capitalised through the current counterparty capital charge,
- The rating migration risk which will impact the CVA variability. This latest risk could be addressed using a separate charge similar (in terms of concept and method) to the IRC charge,

but excluding the impact of defaults in the loss calculation (since it is already taken into account in the counterparty charge).

In the same way the recognition of all hedges in the trading book proposed approach provides incentives to monitor and risk manage dynamically the counterparty risk and the CVA volatility, the use of CDS should also be recognised in the banking book approach as a strong mitigant to the counterparty risk. Such recognition could be achieved using either the double default framework or the substitution approach.

Criticism of the bond equivalent approach

First of all, simulations has shown that the necessary capital computed within the bond equivalent framework as it is proposed in the consultative paper could be 50 time higher than the actual one requested for corresponding credit risk.

Secondly, compared to the two approaches presented above, the bond equivalent appears as a bad compromise between the two. It combines a “credit” exposure and capital charge with a “market var” approach.

If the risk is dynamically managed as a trading book position, with CVAs computed using market credit spreads, the bond equivalent does not correctly represent the CVAs sensitivities to market risk factors. The one year VaR is not consistent with other trading book positions capital charge. The ineligibility of all hedges but single name CDS is also inconsistent with the real management of this position where other instruments can help manage interest rate or exchange rates risk. Also even though index CDS would not be fully efficient to hedge default risk, they do help hedge the sensitivity of CVAs to market credit spreads and should thus be eligible. Their efficiency would be measured by the VaR framework.

If the risk is carried as a banking book position, with CVAs computed using historical probabilities, a full market VaR measuring the sensitivity to interest rates, exchange rates and market credit spreads does not reflect the real risk.

Double countings

There is already a double-counting in the current framework, as the absolute amount of CVA is not fully recognised as a mitigant for the counterparty risk capital charge.

CVAs are reserved from the bank’s result, and if a default occurs, the CVA is available to offset the whole or part of the loss when a claim needs to be provisioned. In that respect, for the part of the loss where a bank holds an amount of CVA, it is unnecessary to have a capital charge, as the CVA is already reserved for that loss.

Some institutions use CVAs to offset the counterparty risk regulatory expected loss, the same way provisions can be used to offset the credit risk regulatory expected loss.

However, very often, CVAs are larger than the regulatory expected loss and the excess of CVAs over the regulatory expected loss is only eligible for Tier 2. This means the excess is not recognised at all for the computation of the Tier 1 ratio.

We believe that the recognition of CVAs as Tier 2 is inefficient. As CVAs are fully dedicated for well identified counterparts, the excess of CVAs over the regulatory expected loss should be deducted from the regulatory capital charge for counterparty risk, rather than being made eligible to Tier 2 capital.

Double countings – second part

As explained above, CVAs are reserved to protect the bank against a default of well-identified counterparts. They are computed as an economic expected loss for the counterparty risk and depending how they are computed (market credit spread or historical probability) they can represent sometimes much more than the regulatory expected loss.

If on top of the CVA, we put aside a capital charge to protect the bank against the potential increase of these CVAs during the coming year, it means that we put aside today not only the CVA, but this new capital charge as well.

Referring to the previous paragraph, this means that we increase the double-counting we were speaking of previously. The more CVAs we have the less a loss due to default will affect the bank. The CVA plus this new capital charge are in total double counting with the current capital charge for counterparty risk.

If we were to adopt the trading book approach described above, there would be no remaining capital charge for counterparty risk, so there would be no double counting any more.

If there was a standalone VaR, or if the counterparty capital charge remained instead of the incremental risk charge, or if we were to adopt the banking book approach, there would be a double counting between the absolute amount of CVA plus the new capital charge to reflect the potential increase of CVA, and the regulatory expected loss and unexpected loss for counterparty risk.

In no real scenario, would a bank make a loss due to the CVA PLUS a loss at the time of default. Hence, in each of the three configurations described above, the new capital charge for the increase of CVA should be compared to the full capital charge for counterparty risk ($EL+UL-CVA$), and the maximum should be retained. Hence, in each of the three configurations described above, the new capital charge for the increase of CVA should be compared to the full capital charge for counterparty risk ($EL+UL-CVA$), and the maximum should be retained.

b. A multiplier for the asset value correlation for large financial institutions (BCBS 164, §135–140)

We recognise that there is some rationale, on past data and experience, to review the calibration of asset correlations for financial institutions. We regret the Committee has not

further detailed the empirical evidence supporting the proposed figure of an increase of 25%, which would have allowed us to provide additional comments.

We point to the fact that this measure will penalise the inter-bank money market, which has already been hit by the strengthening of the large exposure regime under CRD II. Accordingly, we suggest careful consideration in the calibration of the measure that will be detrimental to the implementation of central banks' exit strategies, as well as to the international trade and export financing.

Further, we note that the proposed measure has the following weaknesses:

- It is backward-looking: considering the numerous changes being implemented and/or considered in the banking sector structure and regulation, there is no reason to believe that past correlations are any guide to future correlations,
- It is very blunt as it does not differentiate between various business models across financial institutions (e.g. universal/retail banks vs brokers/dealers), and
- It provides perverse incentives as it penalises more significantly highly rated counterparties.

More generally we consider that additional work would be required to review the calibration of these asset correlations and we would strongly support that bank be allowed to model correlations internally as part of the IRBA approach. Moreover, the definition of "large financial institutions" has to be developed.

From a more technical perspective, we suggest the following amendments to the Committee's proposal:

- Apply the size threshold to all counterparties, irrespective of whether they are regulated or not. In our view, the fact that a firm is regulated is not a significant driver of its systemic correlation and there is no convincing evidence in the recent crisis that small hedge funds are more correlated than small banks. Further this would avoid level-playing field issues as the definition of a 'regulated' institution may vary across jurisdictions.
- Use 'net asset value' as the relevant size metric rather than total assets. Indeed, 'total assets' is not a comparable metric across industry sub-segments (eg banks vs insurance) and may be largely distorted by differing accounting standards (eg IFRS vs US Gaap). We suggest using NAV (or total equity) as a better metric, using an adjusted threshold (eg \$3b).
- Exclude mutual funds from the scope of the measure. Indeed, the recent crisis has not evidenced any specific risk issue with mutual funds, as they are remotely, if not at all, levered (most regulations such as UCIT will limit borrowing to 10% of total assets).

Treatment of highly leveraged counterparties (BCBS 164, §163-164)

We stress that the concept of 'performance of assets based on period of stressed volatilities' underlying the proposed measure is very unclear, if not conceptually wrong. While 'long-only' mutual funds may have relatively predictable performance patterns based on their asset

class, it is important to realize that hedge funds use very diverse and changing investment strategies which may not necessarily perform badly in stressed markets. For instance, ‘long volatility’ funds will actually benefit from stressed volatilities. More generally, most hedge funds (and in particular ‘multi-strategy’ funds) have the capacity to significantly alter their exposures in a relatively short time span, so that the composition of their portfolio at any given point in time may not be reflective of their actual risk profile in a stressed period.

It is therefore essential to take a holistic view, as we do, when assessing the risks and PD of hedge funds to take into account, among others, investment strategy, liquidity of assets, leverage, redemptions etc.

Additionally, we find that the proposal seems contradictory with the ‘through the cycle’ rating philosophy underpinning the Basel IRB framework and it is worth noting that our rating methodologies already include a large dose of conservatism for counterparties such as hedge funds.

Further, the scope of the proposed measure would need to be clarified as it could be interpreted to include investment banks or similar institutions.

Accordingly, we advocate removing the measure or at the very least clarifying that this should only apply to unregulated counterparties.

Addressing reliance on external credit ratings and minimising cliff effects (BCBS 164, §178–184)

We support the proposed measure.

Standardised inferred rating treatment for long-term exposures (BCBS 164, §189-191)

We support the proposed measure.

Incentive to avoid getting exposures rated (BCBS 164, §192-194)

We do not understand the rationale of this proposed measure.

We consider that the provisions of pillar 2 already cover the situation where the minimum capital requirements under pillar 1 would not be sufficient to ensure the capital adequacy at overall bank level.

While banks will systematically assess the risk profile of their exposures, regardless of whether they are externally rated or not, we find it conceptually wrong, and operationally cumbersome, to add a requirement to assess the adequacy of capital requirements at individual exposure level. It would be a significant departure from the Committee’s past practice, and in our view unwarranted, to achieve capital requirements that would be ‘correct’ at such a granular level, thus ignoring the benefits that diversification may bring at portfolio or bank level.

Accordingly, we reject the proposed measure.

9-Leverage ratio

We strongly put the leverage ratio concept into question as an effective way to control risks or improve the resilience of the banking sector:

The leverage ratio may have had its rationale in the “good old days” but is nowadays totally powerless to assess the leverage level of the economy. Except for its apparent simplicity, the Leverage Ratio has no objective and clear justification. No demonstration has been convincingly made of its ability to keep the leverage of the economy within a reasonable range compatible with the financial stability, in particular in the jurisdictions where it was in force such as the USA.

Taming excessive leverage may be legitimate in certain circumstances but cannot be only achieved through a single banking ratio. Such leverage ratio is harmful to the exit strategies of central banks as, commingled with the hardened solvency and liquidity ratios it will create conflicting pressures to reduce balance sheets, especially inter-bank money markets and repos which combine high volumes and low risks. It will also create a pressure to reduce lending and may thus be harmful to the economy.

Given the conceptual flaws of the leverage ratio, we are strongly opposed to a migration to Pillar 1. If a leverage ratio were to be imposed despite the lack of evidence as regards its efficiency, it should be maintained in Pillar 2.

The proposed leverage ratio has unclear objectives. Conceiving it as a possible Pillar 1 hard rule is an historic error and is totally at odds with the successive risk sensitive BCBS solvency reforms. It must solely remain a Pillar 2 indicator. The level of banks’ leverage ratio is impacted by many external factors like the accounting and consolidation standards –for instance the accounting of repos- and the prudential rules for the valuation of assets, derivatives and other off balance sheet commitments..

The leverage ratio cannot be read, as well, without considering the banking business mix, the structure of the financial markets concerned, the level of intermediation, the existence of actors absorbing part of banks’ off-balance sheets. This analysis is all the more justified as the proposed crude approach inflates significantly the level of apparent leverage.

The ratio or rather its evolution needs therefore to be carefully interpreted by the supervisor in conjunction with other indicators before any conclusion can be drawn.

In any case the “crude and neutral” proposed definition of the leverage ratio is only conceivable as an undisclosed Pillar 2 indicator, as unless it is read in conjunction with other key risk indicators, it can be misinterpreted and in the end be completely misleading for the market.

Because of its complex interpretation, the concerns expressed above and its classification as a Pillar 2 component, we are strongly opposed to its disclosure as recommended by the CP and trust it should remain information only disclosed in the course of the dialogue with the supervisor.

10-Pro-cyclicality

1/ Cyclicity of the minimum requirement

The French Banking Federation believes that the pro-cyclical nature of Basel 2 framework, if correctly implemented, is not demonstrated nor shown in actual data.

The Basel 2 framework has introduced a great number of safeguards against excess cyclicity (long term data horizons to estimate PD, downturn LGD, stress tests considering downturn migration, etc...).

Moreover, the use of the highest average PD estimate or the average of historic PD estimate to each of the bank's exposure classes would be a strong disincentive to review obligor's ratings and would not meet the 'use test' requirement.

We believe that the whole concept that aims to correct the so-called pro-cyclicality of the Basel 2 framework is flawed. We reject it as such but we advocate the Basel Committee to require all countries to be compliant with the Basel 2 requirements, in particular as far as the "Through the cycle" concept for Basel 2 parameters and the Pillar 2 requirements.

2/ Forward looking provisioning

The French Banking Federation has pinpointed, since 2002, the weaknesses of the IASB's incurred losses model for provisioning credit risk. The crisis confirmed our analysis: during the period 2005-2006, banks have to release previously built provisions due to the benign economic conditions, when in same timeframe, their loans portfolios were growing significantly. Therefore, we are in favour of a more forward looking approach that suppresses the overstatement of interest revenues in the periods before a loss event occurs.

The IASB provide with a proposal based on an expected loss approach, but, in our views, the exposure draft 2009/12 presents three fatal flaws:

- The use of TTC parameters is prohibited, though nobody is able to predict the behaviour of the economic cycle through the whole life of most loans portfolios. PIT data will lead to a sharp increase in procyclicality of banks' provisionning
- Changes in expectations for losses are recorded immediately always in P&L, despite the fact that risk premiums included in interest revenues are collected over the loans maturities.
- Credit losses are incorporated in EIR calculations, even it is impossible to predict accurately when the expected losses will occur. Furthermore, this methodology raises huge operational challenges.

European Banking Federation is currently developing an alternative to this model, aimed at achieving the same objective, without these drawbacks.

The main features of this project, sponsored by all Europeans Banking Federations, are:

- Historical losses experience provides the basis for estimating expected losses. French Banking federation is of view that, in most circumstances, TTC Basel 2 parameters, are the best proxy for historical losses experience
- Parameters are adjusted to reflect changes in credit policies distribution
- The corresponding provision is built over the average life of the portfolios
- Portfolios are defined according to the Basle segmentation standard approach
- Adjustments to expectation are spread over the remaining life of the portfolio until a threshold to be defined. Significant adjustments may have to be taken in full in P&L as they occur
- Incurred losses (defined as now in IAS 39, excluding IBNR losses) are booked against the corresponding expected loss allowance.

We think that this model has to be developed to achieve sound expected loss provisioning approach. We notice that it is fully compliant with the six principles adopted by BCBS in this matter.

As the accounting calculation of expected loss will be built over *at termination*, we expect the prospective provisioning framework to produce an excess of provision over the Basel 2 one year Expected Loss benchmark.

Under the current Basel 2 rules, this excess will only be recognized as Tier Two capital and capped.

We therefore ask, if the new accounting rules once stabilised confirm the contemplated orientation :

- 1) for a revised prudential mechanism which will allow, through a filter, to include this excess of provisions in the Core Tier One (as these amounts would have impacted the earnings and therefore depleted directly the Core Tier One), at least during down turn periods when the prospective provision is inflated by the high incurred specific provisions;
- 2) and, in addition, the suppression of the 0.6 % cap based on risk weighted assets.

3/ Capital buffers through capital conservation

The French Banking Federation regrets that the calibration of these buffers is based on unknown methodology and does not seem to have any theoretical grounds.

Furthermore, we are highly skeptical as to the potential effectiveness of the capital buffer concept and do not understand how the objective of this measure will really be achieved: banks will be allowed, neither by their supervisor nor by the market, to use their buffer when the economic situation gets worse. As experimented during the crisis, market participants, investors and rating agencies expect banks to hold *additional* capital and not less capital during times of economic stress conditions. Thus, buffers that cannot be used would become another capital requirement, above the minimum capital requirement. Combined with the other measures regarding liquidity, leverage ratio and new capital requirements, it will force banks to reduce tremendously new lending to the economy.

We can also argue that this measure is contrary to our legal framework where distributions of earnings are determined by the shareholders meeting. The intrusion of the supervisory bodies in the banks' management seems to us excessive and fundamentally not consistent with the independence principle between the supervisors and the bodies under control.

Besides, we consider that the application of any potential measure developed in this area is meaningless at a solo level.

Finally, we consider that such a provision should not be anything else than a Pillar 2 requirement. Our feeling is that the best way to tackle this issue is to improve the proposed accounting standards on forward looking provisioning so that they become in line with the prudential point of view. There will then be no need for additional prudential rules (see above).

4/ Excessive credit growth

The proposal to limit the excessive credit growth is too imprecise both in its content and its scope to be seriously taken into account. Neither the definition of any potential use of buffers for macroeconomic purposes, nor the macro variables to be considered are sufficiently clearly specified to support this approach. We think that further consideration is needed in order to determine the right approach to the macroeconomic use of additional capital buffers. We advocate not proceeding at this stage with concrete proposals and spending all the time needed to cope with the issue.

Once more, our feeling is that the best way to tackle cyclical issues is to improve the proposed accounting standards on forward looking provisioning so that they become in line with the prudential point of view. There will then be no need for additional prudential rules (see above).

Detailed comments on BCBS 165 – Liquidity

FEDERATION BANCAIRE FRANCAISE WORKING GROUP ON LIQUIDITY RESPONSE TO CONSULTATION PAPER ON *INTERNATIONAL FRAMEWORK FOR LIQUIDITY RISK MEASUREMENT, STANDARDS AND MONITORING*

French Banking Federation (FBF) welcomes the Basel Committee on Banking Supervision (BCBS) Consultation Paper (CP) on “*International Framework for Liquidity Risk Measurement, Standards and Monitoring*” and supports the efforts that would lead to a global level playing field in a strengthened financial system.

The two binding standard funding risk metrics that are suggested, namely the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), are very similar, in essence, to what French banks have been using for more than 20 years. This has certainly contributed to the strong resiliency of French banks in the direst funding¹ and liquidity crisis over the last 80 years. **FBF concurs with a funding risk measurement framework based on a combination of NSFR and LCR to abide by.**

These two metrics should rightly be considered as part of a range of funding risk metrics used by each bank to monitor and manage funding risk. The Monitoring Tools that are suggested in the CP are of varying values for actual funding risk management².

Even though appropriate risk metrics in essence, **the current hard-wired runoff / rollover assumption sets for LCR and NSFR are too extreme and need to be modified.**

The one-size-fits-all assumptions and thresholds do not recognize any advantage to banks that are stronger than others. For instance, the CP ignores the diversification of banks’ businesses, sources of profitability, and sources of funding... **The CP is oriented exclusively on factors that are bank-exogenous and totally oblivious of bank-endogenous factors that are as important in sound funding risk management, and that play a fundamental role in defusing funding stress scenario in the first place.**

THE SUGGESTED REGULATION WOULD BE PRO-CYCLICAL:

The liquidity crisis has shown that dependencies between economic agents need to be taken into account: banks, clients, central banks, shadow banking systems, rating agencies... The CP ignores most of those dependencies.

As an example, High Quality Liquid Assets are suggested to be agency rating-dependent. First, this means that the liquidity risk position of the entire banking industry is dependent on rating agencies that are not regulated. Second, a wave of credit-driven downgrades would have monetary-like consequences through rendering securities illiquid from a regulatory standpoint, even though their actual liquidity may not change.

Conversely, knowing that their decisions have consequences on the whole banking industry, rating agencies could be more reluctant in delivering downgrades.³

¹ On purpose, this paper will refer to funding risk so as to differentiate it from the (asset) liquidity risk.

² The contractual cash flow mismatch is basically useless and could even have counter-productive effects if wrongly analyzed by non specialists.

³ The Greece issue has proven that this is not a theoretical issue: if Moody’s were to downgrade Greek debt, it would no longer be European Central Bank eligible (since European

The spill-over effects of the CP need being carefully analyzed.

Another example comes from the definition of High Quality Liquidity Assets. Central banks are excluded from systemic liquidity crisis management, since central bank eligibility is not a criterion *per se* for an asset to be recognized liquidity in such a crisis.

Basically, the CP assumes that in a systemic crisis, all banks, facing the same systemic crisis, would sell the same type of narrowly-defined-securities at the same moment. This would certainly lead to fire-sales, which would drive down the values of those securities and the amount of liquidity buffers at the time they are most needed, which would lead banks to anticipate and accelerate the sale process. As those securities are mostly government bonds, spreads of those government bonds would increase significantly, which could even lead market participants to question the government credit quality.

Besides, a large sale of government bond securities could be interpreted as a liquidity crisis in the making, potentially triggering liquidity crisis if the environment is rumour-prone. If a bank were to experience a bank-specific liquidity crisis, it would be led to sell so called High Quality Liquid Assets, signalling that it has a liquidity crisis, worsening its liquidity position and favouring the spill over effects of liquidity crisis.

Central bank eligibility actually helps mitigating those spill-over and vicious circle effects.

FBF recommends considering Central Banks as part of the solution in managing market-wide liquidity crises, and recommends considering that central bank eligible assets are part of the LCR-liquidity buffer.

The consultative paper requires disclosing liquidity risk metrics. When market risks or credit risks are disclosed, the readers cannot change the risks that are being disclosed: the readers are neutral on the risk itself (he/she cannot change the market risks or the credit risks of the bank he/she is getting the disclosures from). Liquidity risk is different since the reader of liquidity risk disclosures can change the liquidity risk being disclosed, for instance by stopping its lending to the bank.

As both LCR and NSFR will fluctuate over time, banks will be led and expected to target higher ratios so that a temporary negative trend or the simple variability of the actual ratios over time do not trigger a perception of liquidity crisis that would be self-fulfilling prophecy.

Moreover, in times of actual crisis, LCR or NSFR may be breached, temporarily during the liquidity crisis management. As an example, the LCR-liquidity buffer may have to be actually used to mitigate a crisis, leading the LCR below the applicable threshold and the LCR-liquidity buffer to be below its pre-crisis required level. There is no doubt that LCR and NSFR should be readily disclosed to supervisors.

FBF recommends limiting disclosures to the colleges of supervisors.

Appendix A lists other consequences of the suggested regulation, most of which could not have been intentional in elaborating the CP: they are most probably unintended consequences.

PRELIMINARY ASSESSMENTS SUGGEST THAT THE CONSEQUENCES OF THE CP WOULD BE VERY DISRUPTIVE:

The simulations of required additional term funding that French banks have done lead to so huge amounts that a combination of massive de-leveraging and increase in funding costs for customers would be needed to abide by both NSFR and LCR, at massive expense for the economy as a whole.

Central Bank eligibility is agency rating-based as well!), which would certainly decrease Greek debt liquidity and hurt Greece funding needs to the point of self-fulfilling the downgrade in the first place!

Should the similar assumption sets be kept and liquidity risk framework become compulsory by end 2012, banks would have to prepare from early 2011 to those massive changes. This would definitively endanger the fragile economy recovery process that is expected to take years.

FBF considers that the hard-wired assumptions need to be substituted with more risk-based assumptions consistent with the scenarios they relate to: idiosyncratic for NSFR and idiosyncratic combined with the start of a market-wide stress test for LCR.

The consequences of the liquidity framework for the whole economy need to be carefully analyzed. The ongoing Quantitative Impact Study (QIS) will certainly help in measuring the impacts for banks but will not enable to anticipate how banks will adapt their business models to the changes in the regulation. **FBF suggests complementing the ongoing process with a Qualitative Impact Study which could take the form of hearings / roundtables between colleges of supervisors and banks.**

THE LCR AND NSFR ASSUMPTION SETS ARE TOO EXTREME:

In a nutshell, the main issues are described below (cf Appendix C for detailed FBF comments on each CP paragraph):

- **LCR assumption set:**

- **The liquidity buffer is too narrowly defined:**

- In a market-wide stress test scenario, central banks should be considered as part of the crisis managing stakeholders. Either the LCR stress test scenario is a market-wide stress test and the central bank eligible assets should be part of the liquidity buffer, or central bank eligible assets are not part of the LCR liquidity buffer and the LCR scenario should be idiosyncratic stress test-based (ie less severe a scenario).
 - The factors that are applied to the corporate and covered bonds are too severe.
 - The securities that are not qualifying for the liquidity buffer are not recognized any liquidity value in the cash inflows. The repo no-rollover assumption on those securities is too extreme. This binary approach should be substituted by a more progressive approach with a broader range of liquid assets with their accompanying liquidity factors.

- **Securities issued by financial institutions should not be singled out:**

- Assuming 100% runoff of all financial institutions deposits is too extreme and not evidenced by the recent crisis.
 - Financial institution is too broad a category. It should be broken down in smaller categories.
 - Stickiness factors are too narrowly defined and should apply to financial institutions too.

- **The 100% drawdown assumption on liquidity lines is too extreme.** It should be broken down by counterparts and revised down (notably in light of evidence observed during the crisis)

- **Banking liquidity supervision should be consistent with legally binding commitments:** revocable uncommitted lines should not be considered, owned liquidity lines should be given a liquidity credit (and not denied as is suggested in the CP), reputation risk is not a commitment, off balance sheet commitments cannot be extended beyond their contractual maturities (only transactions with residual maturity longer than 1 month should be considered in the LCR).

- **NSFR assumption set:**

- In a 1 year long idiosyncratic stress test scenario, **the bank cannot be assumed not to adapt its business models** and keep doing business-as-usual: loan rollover assumptions

(85% for retail, 50% for corporate) are too severe. Loan origination scale-down assumptions need to be considered. Those assumptions are necessarily bank-specific as the businesses that could be scaled down are bank-specific. Capital market activities are among the easiest to scale down, as well as business that are exclusively asset oriented (ex: consumer loan business line, leasing activities...). Appendix B focuses on the NSFR loan roll over assumption.

- Market-liquidity criteria for an idiosyncratic stress test scenario should *not* be the same as for a market-wide stress test: market liquid assets that do not qualify for LCR-liquidity buffer should be recognized more NSFR liquidity than currently allocated.
- Expected prepayments should be taken into account for what needs to be longer than 1 year term funded.
- The categories “all other assets” that are required to be fully funded at longer than 1 year horizon and “all other liabilities” that are recognized no funding value need careful attention. As an example, if applied to trading derivatives’ values in the balance sheet, it would not make sense: absent any netting it would require huge and unjustified amounts of funding which would not be manageable as the values of such derivatives can vary massively over time and switch from the asset side to the liability side (some derivatives such as swaps can be an asset at one time and a liability at another time).
- **Banking liquidity supervision should be consistent with legally binding commitments:** off balance sheet commitments cannot be extended beyond their contractual maturities.

The sentence “*Banks and supervisors cannot assume that currencies will remain transferable in a stress, even for currencies which in normal times are highly convertible*” (end of CP§134) may be interpreted by supervisors such as to require LCR and NSFR to be met for each currency. **Convertibility shutdown for usually highly convertible currencies would be too extreme an assumption.**

FBF SUGGESTION: A TWO LAYER RISK MEASUREMENT FRAMEWORK WITHIN A COMPREHENSIVE LIQUIDITY RISK MANAGEMENT FRAMEWORK:

Funding risk management does not boil down to funding risk metrics, how numerous, diversified and complex they might be. The entire funding risk management framework should be considered, as illustrated by the Seventeen Principles that the BCBS established in its September 2008 document “*Principles for Sound Liquidity Risk Management and Supervision*” (cf Appendix F).

The fundamental building blocks of a robust funding risk management framework are those that make sure that funding risk is part of the bank culture, from board members to individuals in the organization. As elaborated in the Seventeen BCBS Principles, they relate to: governance, information technology, internal fund transfer pricing system, funding risk measurement, funding risk operational management. **Funding risk measurement is only one of the fundamental building blocks.** It should not be seen in isolation from the other building blocks of the funding risk management framework.

Moreover, funding risk management is closely related to the businesses the bank is involved in, its business model, its customer base, its competition, capital markets it has access to, its regulatory environments, the economy as a whole with its ever ongoing globalization process, etc. A one-size-fits-all approach cannot be adapted to all the possible combinations of all those components.

Even though similar funding risk metrics may be helpful in establishing a common measurement language, it would be misleading for all stakeholders to believe that they can

adequately summarize funding risks of banking groups that are diversified in terms of businesses, legal entities, countries, currencies in highly standardized risk metrics ...

Within the Seventeen BCBS Principles, FBF suggests a comprehensive liquidity supervisory framework with a liquidity risk *measurement* framework that would allow different approaches, very similar to the Basel II solvency requirements for market and operational risks.

Such approaches would be LCR- and NSFR-based with assumption sets on runoff/rollover factors that would be either:

A. standardized (cf Appendix E for suggested changes to BCBS proposals), or

B. bank-specific subject to review and validation by supervisor (Appendix D).

FBF suggests working with the BCBS on:

- fine tuning the NSFR and LCR standardized assumption sets; and
- elaborating the criteria for advanced risk measurement framework.

SCOPE OF APPLICATION:

Applying the CP at sub-consolidated levels would magnify the disruptive effects of the CP on the banking industry, and consequently on the economy as a whole: **FBF recommends limiting the scope of application to the consolidated level.**

Should sub-consolidated levels be considered, they should *not be smaller than* pools of entities when the following criteria are met:

- **actual liquidity risk management is global to the pool of entities;**
- **capacity to transfer liquidity;**
- **legally binding commitments between the entities.**

Subject to those criteria, a host supervisor should liaise with the college of supervisor, potentially by being a member of this college, to address liquidity issues: ***no host regulation should be required to any specific entity, or group of entities, within the pool of entities that meet those criteria*** (there should be an automatic waiving process). Certainly, **this will require clearly articulated a governance between the supervisors.**

Additionally, **intra-group transactions**, be they within between entities in the same group of pooled entities, or between entities that are in different groups of pooled entities (some of which may be constituted of a single entity) **would need to be treated with assumptions that:**

- **should be consistent with legally binding commitments;**
- **should be symmetric from both sides of the internal deal;**
- **should be consistent with the rollover assumptions of the transactions that are ultimately funded / invested. If an activity is scaled down in the stress scenario, the scale down assumption should be applied to the same extent to intra-group with this subsidiary.**
- **may be differ within the same Group** (ie: not necessarily a single method in a specific Group)

TRANSITION PROCESS TO A NEW LIQUIDITY RISK MEASUREMENT FRAMEWORK:

The changes in liquidity risk supervisory framework will have far reaching consequences well beyond the banking system. Considered as a whole, the banking system is just an intermediary whose role is to channel liquidity excesses from specific economic agents in specific jurisdictions (ex: households) to other specific economic agents in needs of liquidity

in other specific jurisdictions (ex: corporates). Modifying the liquidity transformation and channelling function of the whole banking system will necessarily affect the entire economy.

History has shown repeatedly that economic crises that trigger de-leveraging are deeper and longer than other types of economic crises. As of mid-2010, the economic growth is fragile and expected to be sluggish for years to come. The new liquidity requirements' effects on the entire economy need to be carefully thought-through, anticipated, disclosed and accepted by stakeholders well beyond the banking industry stakeholders.

Besides, the one-size-fits all approach that is suggested will magnify the impacts on the entire economy from the beginning of the transition period: all banks will have exactly the same incentives for changes and will adapt simultaneously and very similarly their business models.

That's why, **FBF suggests the transition process described below:**

1. Regulatory framework set up:
 - a. Ongoing consultation process:
 - i. Transparent Analysis of the Quantitative Impact Study, with its consequences on the economy as a whole;
 - ii. Hearings / Bilateral discussions between supervisors and banks for suggested changes
 - iii. Feedback on received comments
 - iv. Updated liquidity framework subject to a consultation process
 - b. New consultation process on an updated proposal
 - c. Final liquidity framework
2. Progressive transition to the new regulatory framework so that the impacts on the economy and the required banks' adaptations are spread over time, and banks have the time to adapt their systems to the new requirements. This could be implemented with binding thresholds that would be increased progressively over time. The length of the transition period would be fine tune with the second round of impact study analysis.

Finally, so as not to create comparative disadvantages and uneven playing field between banks subject to LCR and NSFR requirements and other banks, **the liquidity regulation should apply to all banks** (be they internationally active or not), **in all jurisdictions** (US, Asia, Europe...), **with the same transition process, notably in terms of timing.**

FBF is looking forward to constructively working with BCBS on necessary changes to the CP.

Appendices:

The elements described above are detailed in the appendices.

- Appendix A: Unintended Consequences
- Appendix B: Focus on NSFR rollover assumption
- Appendix C: Detailed Consultative Paper Comments
- Appendix D: Advance Liquidity Risk Measurement Framework
- Appendix E: Suggested Changes to the Standardized LCR and NSFR
- Appendix F: BCBS Seventeen Principles of Sound Liquidity Risk Management

APPENDIX A: UNINTENDED CONSEQUENCES FROM CURRENT BCBS CONSULTATIVE PAPER

This appendix describes a few consequences of the BCBS Consultative Paper, should it be applied as is. Most of those consequences are most probably unintended and need to be paid attention to when elaborating the next BCBS Consultative Paper.

DECREASE IN LIQUIDITY:

The narrowly defined High Quality Liquid Assets (HQLA), whose presumed market liquidity is the reason for their selection in the LCR-liquidity buffer, would lead all banks to buy and *hold* the very same securities: those securities would become trapped and stuck in banks' balance sheets. **HQLA would become less liquid!** This would be compounded by the requirement to hold those assets in the sole intent of building and holding a huge LCR-liquidity buffer.

In a stress test event, all banks would be led to sell the very same type of assets, which would drive down their prices, decrease the amount of available liquidity. This would trigger a vicious circle: liquidity crisis => HQLA sales => HQLA price decrease => decrease in available liquidity buffer => increase liquidity crisis.

If the crisis occurs in a specific country, the type of sold HQLA would be very similar: large amount of country government debts would be sold by the banks of that country. The decrease in government debt prices would increase spread of the country government debt, which would lead market participants to question the country government credit quality, which would increase the funding of banks of the same country (the current crisis is evidencing that funding costs of all banks of a specific country are dependent on the government funding costs).

Securities that are not qualifying for LCR-liquidity buffer are deemed not being liquid through either sale or repo rollover require term funding, from both NSFR (1 year term funding) and LCR (1 month term funding) requirements. This would increase their carrying cost and decrease the repo activity on those securities: those assets would become less liquid. This is another example of self-fulfilling prophecy: **if regulation-deemed illiquid, securities that are excluded from HQLA become less liquid!**

As HQLA are credit rating-driven, a wave of rating downgrades would decrease the LCR-liquidity buffer: **this would correlate credit cycle and liquidity cycles**. Globally, the vicious circle would be: decrease in credit quality => decrease in HQLA => decrease in banks' funding capacity => weaker economy => decrease in credit quality.

These suggest:

- *widening the assets that can qualify for the liquidity buffer,*
- *... notably to central bank eligible assets, not to exclusively count on market liquidity to mitigate a liquidity crisis*
- *make sure that the LCR liquidity buffer are operationally accessible in times of crisis instead of requiring liquidity buffer assets ring-fencing*
- *acknowledging liquidity to a large sets of assets in both LCR-cash inflows, and NSFR, notably with evidence based repo roll over assumptions*

INCREASED SYSTEMIC RISK:

The one-size-fits-all approach that is suggested would lead all banks to adopt the same behaviour pattern in business-as-usual mode and even more so in stress test mode (ex: sales of the very same type of assets described above). The alignment would occur in the transition to

the new regulation as well. **Aligning all market participants along the very same detailed rules would increase systemic risk through fostering herd behaviour.**

The one-size-fits-all approach does not recognize any comparative advantage for stronger banks. The risk-reward trade-off would be very similar for all banks, which would lead to similar business mix choices for all banks.

Bank specific assumptions and bank specific thresholds for NSFR would mitigate the systemic risk and create incentive for banks to strengthen even more their funding risk management.

Disclosures of funding risk metrics could magnify a nascent (or a wrongly interpreted nascent) funding risk.

Funding risk metrics should be readily disclosed to supervisors.

The punitive 100% drawdown assumptions on liquidity lines would disincentive banks from originating such lines. The liquidity risk would not disappear, but would be transferred outside the banking industry that has the necessary expertise, the managing tools and the supervision to cope with that risk. This risk transfer would apply to funding risk as a whole: the liquidity transformation that is necessary for the economy would take place outside the banking industry.

More reasonable assumptions for both LCR and NSFR would help avoiding the transfer of funding risk outside the banking industry.

ADVERSE EFFECTS ON GDP GROWTH:

The increased costs of required term funding would need to be passed to banks' clients or avoided in the first place by a decrease in offered loans. In both case, this will negatively affect the GDP growth.

The huge amounts of additional NSFR-required funding needs will lead banks to massive long term borrowings, in the very same period as government needs to finance their budget deficits. This will drive long term rates up, which will be detrimental to the GDP growth.

More reasonable assumptions for both LCR and NSFR would help avoiding the transfer of funding risk outside the banking industry.

If required at sub-consolidated levels, the suggested funding regulation will curb the flow of liquidity from locations with excesses of funds to locations in needs of funds: this will be detrimental to GDP growth.

Requirements at sub consolidated levels should be as limited as possible.

OTHER:

If not applied to all banks in all jurisdictions with the same transition process and timing, the playing field will not be even.

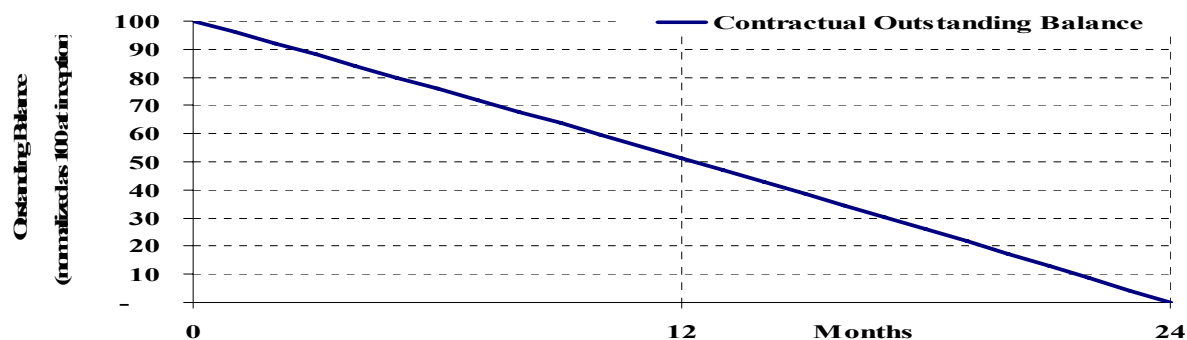
The NSFR requirement is so stringent that banks would be led to long term borrow huge amounts to the point of decreasing, if not cancelling out, their short term borrowings. In this context, monetary policy that is transmitted essentially through banks' short term borrowings would be less efficient, depriving central banks from their most important management tools (ie short term rate).

Extending funding regulation beyond what is legally binding is not only extreme but could create legal commitments that did not exist in the first place. As an example, knowing that banks have to term fund a portion of revocable uncommitted lines, banks could be considered to be committed to the extent of that portion.

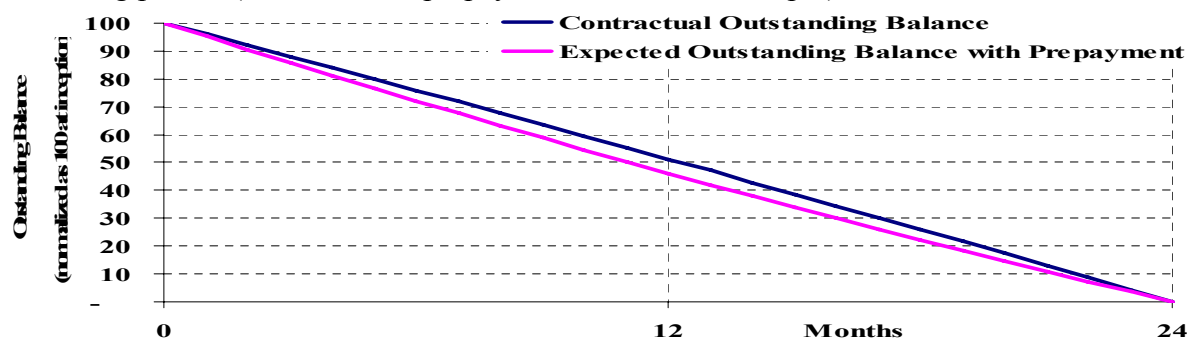
APPENDIX B.1.: CURRENT NSFR ROLLOVER ASSUMPTIONS NEED BEING CHANGED

A. Application of the NSFR requirement on a simple example: inventory of 2 year amortizing loans

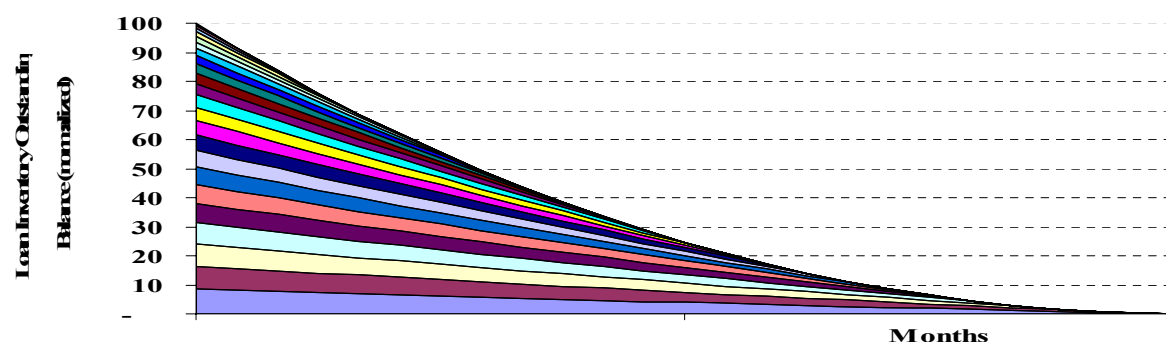
Let's take the example of a 2 year loan which is amortizing with constant principal plus interest cash flows (assumed 5% fixed rate loan). Its amortization profile is represented in the graph below (outstanding balance over time):



Prepayments are usually expected for such loans, which leads to a different expected amortizing profile (10% constant prepayment rate in the example):

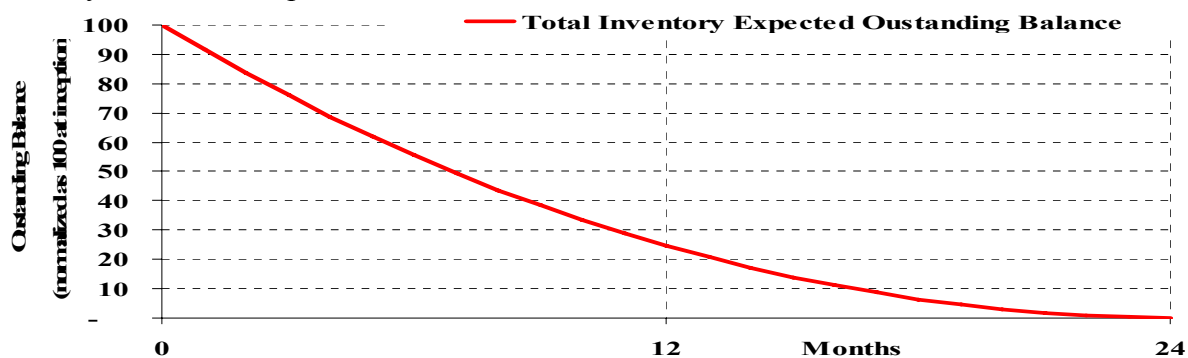


Let's assume that the same amount of such loan is originated each month over a long period. Then the expected amortizing profile of the loan *inventory* is graphed below:



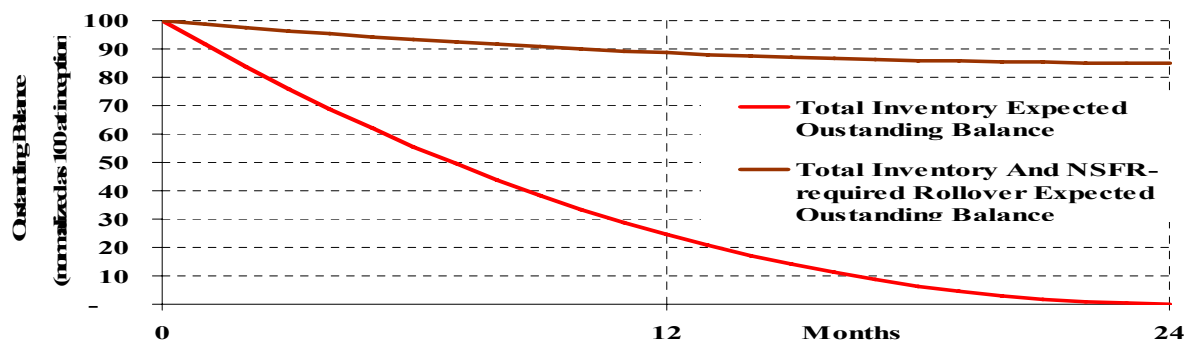
The loan just originated (lowest segment in the above graph) has 24 months remaining life. The loan originated 1 month ago has a 23 months remaining life and has already started to amortize...

Globally, this can be represented as:



For a normalized 100 spot balance, the expected balance at 1 year horizon is close to 25.

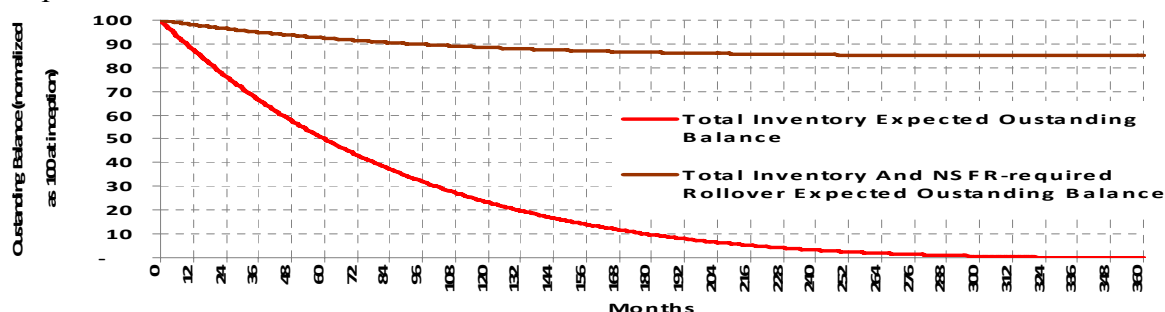
The NSFR rollover assumption requires funding loans *that have not yet been originated*, as graphed below (85% rollover assumption in the example):



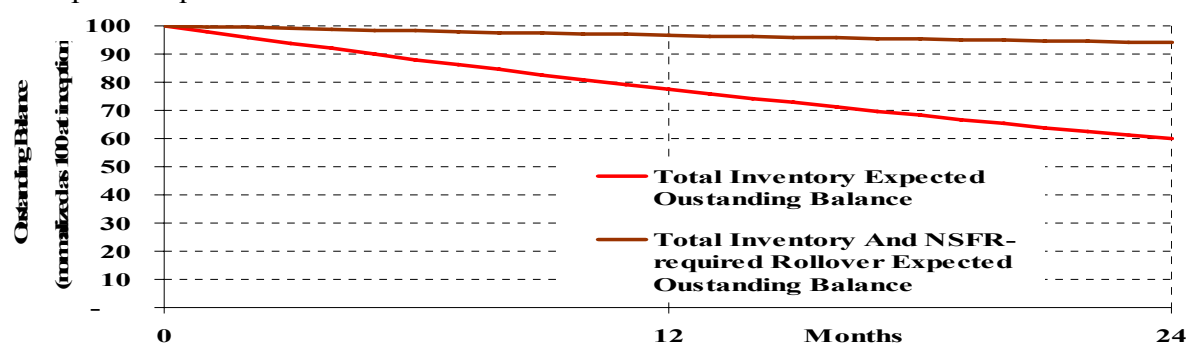
The NSFR requires 89 of longer than 1 year funding: 25 for loans that are actually in the balance sheet and 64 for assumed loans that are assumed to be originated in the next 12 months. This is a 260% increase in required longer than 1 year funding!!!

B. Same method applied to 30 year amortizing loans:

Let's assume that the 2 years loans are replaced with 30 years loans in the above described example. This leads to:



Let's focus on the first 24 months to better visualize the extent of the NSFR rollover assumption requirement:



For 30 year long loans, the NSFR required longer than 1 year funding would then be 98, with 87 from existing loans and 11 from assumed rolled-over loans: that is to say a **12% increase in required funding due to the rollover assumption**.

For 15 year loans, the NSFR required longer than 1 year funding would then be 97 with 82 from existing loans and 15 from assumed rolled-over loan: that is to say a **19% increase in required funding due to the rollover assumption**.

C. Table of increases in longer than 1 year funding due to the rollover assumption:

The table below shows the increase in longer than 1 year funding due to the NSFR rollover assumptions, for the two rollover assumptions suggested by the CP, and a range of maturities for amortizing loans:

		Loan Maturities (months)				
		24	60	120	180	360
Rollover assumption	85%	260%	55%	26%	19%	12%
	50%	153%	32%	15%	11%	7%

For non amortizing loans, the table is:

		Loan Maturities (months)				
		24	60	120	180	360
Rollover assumption	85%	94%	27%	15%	12%	10%
	50%	56%	16%	9%	7%	6%

APPENDIX B.2. : EXAMPLE OF A SIMPLISTIC RETAIL BANK – CURRENT NSFR NEEDS RECALIBRATION

A. Example of a simplified retail bank:

Let's assume the following simplified 100% retail bank:

Balance Sheet as-of-today			
Assets		Liabilities	
Consumer Loans (5y)	96	8	Capital
Overnight Interbank	4	92	Insured Core Deposits
Total	100	100	Total

B. The 1 month funding risk is ok:

Over the next month, the expected principal cash inflow is 3 from consumer loans' amortization and 4 from the overnight interbank lending. This cash inflow amounts to 8% of its core deposits, which is higher than the LCR-assumed 7.5% loss of insured core deposits.

This bank passes the LCR test.

C. The 1 year funding risk seems ok:

Applying the same method as in the previous appendix, the expected outstanding balances are 58 for 5 year amortizing consumer loans. In other words, the 1 year forward looking balance sheet, derived from existing transactions is:

1 year forward looking Balance Sheet derived from transactions in the as-of-today balance sheet			
Assets		Liabilities	
Consumer Loans (5y)	58	8	Capital
Overnight Interbank	0	x% of 92	Insured Core Deposits
Total	58	Total	

Considering that capital is a longer than 1 year funding, the required longer than 1 year funding is: $58 - 8 = 50$, which is 54% of core deposits. Most probably, this bank would consider a higher than 54% portion of its core deposits as stable over 1 year horizon: the 1 year term funding position of the bank is sound.

D. ... but the bank does *not* pass the NSFR test!

With the NSFR rollover assumptions, the required longer than 1 year funding would be: 90.

On the liability side, the insured core deposits are applied 85% Available Stable Funding a factor, which leads to: $85\% * 92 = 78$ available stable funding ratio, to which 8 capital is added to sum to 86 recognized available stable funding at 1 year horizon.

This leads to a longer than 1 year NSFR-funding gap of: $90 - 86 = 4$! The bank would be required to add 4 of additional longer than 1 year term funding, that it will have to invest on short term horizon (so as not to create longer than 1 year funding need directly, or indirectly due to rollover assumption). This would typically lead to the forward looking balance sheet as described below:

**1 year forward looking Balance Sheet
derived from transactions in the as-of-today balance sheet**

Assets		Liabilities	
Consumer Loans (5y)	58	8	Capital
Overnight	0	y% of 92	Insured Core Deposits
		4	Additional 1y+ term funding
Total	58	Total	

From a static perspective, this amounts to assuming that the bank should be in a position to expect not more than: $58 - 8 - 4 = 46$ remaining insured core deposits balance after 1 year, which represents 50% of the as of today 92 insured core deposit balance.

That is to say that the bank is assumed to lose 50% of its existing insured core deposits balance. That is certainly too severe a scenario to impose for business-as-usual funding management!

E. This comes from inconsistent runoff/rollover assumptions:

If core deposits are assumed to shrink (by 15% due to 85% ASF factor), it is weird to assume that loans will be rolled over (85% rollover assumption). In fact, applying the same 85% to both ASF and rollover assumption is inconsistent.

The examples described below look for loan rollover assumptions that would lead to the conclusion that the sound bank passes the NSFR test.

Example with 5 year amortizing consumer loans:

In the above described example, if the 85% ASF is applied to insured core deposits, **the retail bank would pass the NSFR test for lower than 74% loan rollover assumptions** (not 85%). Note that the 74% rollover assumption is very demanding an assumption when core deposits are shrinking.

With a 74% rollover assumption, the 1 year forward looking balance sheet would be:

**1 year forward looking Balance Sheet
derived from transactions in the as-of-today balance sheet**

Assets		Liabilities	
Consumer Loans (5y)	86	8	Capital
Overnight Interbank	0	78	Insured Core Deposits
Total	86	86	Total

Example with 30 year amortizing mortgage loans:

Let's assume that the 5 year amortizing consumer loans are replaced by 30 year amortizing mortgage loans.

To pass the LCR test, the overnight lending needs to be increased:

Balance Sheet as-of-today			
Assets		Liabilities	
Mortgage Loans (30y)	94	8	Capital
Overnight Interbank	6	92	Insured Core Deposits
Total	100	100	Total

Without any loan rollover assumption, expected mortgage loan balance at 1 year horizon is 82, to compare with the 86 on the liability side (8 from capital and 78 from insured core deposits). The bank

Then, if the 85% ASF is applied to insured core deposits, **the retail bank would pass the NSFR test for lower than 34% loan rollover assumptions** (not 85%). Note that 34% loan rollover assumption seems reasonable an assumption when considering an idiosyncratic stress test scenario.

With a 34% rollover assumption, the 1 year forward looking balance sheet would be:

1 year forward looking Balance Sheet derived from transactions in the as-of-today balance sheet			
Assets		Liabilities	
Mortgage Loans (30y)	86	8	Capital
Overnight Interbank	0	78	Insured Core Deposits
Total	86	86	Total

Conclusions from the above described examples:

- 1. The deposit runoff assumptions (ASF factors) should NOT match the loan rollover assumptions, and**
- 2. Rollover assumptions should be revised down to lower than ASF factors.**

A rule of thumb could be to have: rollover assumption = ASF / 2. With 42.5% loan rollover assumption, the 5 year consumer loan bank would pass the NSFR test, whereas the 30 year mortgage loan would not.

F. Example of an asset origination oriented retail bank (ie: specialized financing bank):

Let's consider a specialized retail bank that originates and holds consumer loans, and fund them with term debt:

Balance Sheet as-of-today			
Assets		Liabilities	
Consumer (5y)	96	8	Capital
Overnight Interbank	4	92	Long Term Debt
Total	100	100	Total

Let's assume that the long term debt is such as there is no liquidity gap (from a static perspective, ie gap derived from existing transactions).

At one year horizon, the forward looking balances from existing transactions are expected to be:

**1 year forward looking Balance Sheet
derived from transactions in the as-of-today balance sheet**

	Assets		Liabilities
Consumer Loans (5y)	58	8	Capital
Interbank Lending	0	50	Long Term Debt
Total	58	58	Total

There is no forward looking liquidity gap.

The 85% rollover assumption applied to loans would require the expected 1 year debt balance to be 82 (=90-8), basically twice the outstanding debt at 1 year horizon for the transactions actually in the balance sheet.

If the bank is in a position *not* to originate new loans when an idiosyncratic crisis occurs, there is no reason to require any roll over for this type of bank.

If there are difficulties in stopping new originations, it may make sense to assume a rollover assumption to the extent of the lag between the start of an idiosyncratic stress test and the origination full stop. **Let's say it takes 3 months to full stop the origination process, the rollover could be: 100% over the 1st month, 66% over the 2nd month and 33% over the 3rd month. The additional balance at 1 year horizon due to this 3 month scale down period amounts to a loan rollover assumption of 15%!**

If 5 year consumer loans are replaced with 30 year mortgage loans, the conclusion is the same: the scale down period amounts to 15% loan rollover assumption.

G. Conclusions:

The applicable rollover assumptions should depend on the bank's capacity to scale down, or even stop, its loan origination process in a 1 year long idiosyncratic stress test scenario.

FBF suggests having two scale-down modes with two different loan rollover assumptions, both of which need to be lower than the extreme 85% and 50% current loan rollover assumptions.

APPENDIX C: DETAILED COMMENTS ON EACH BCBS CP PARAGRAPH (§)

The table below details our comment on each paragraph of the BCBS CP paragraph.

Glossary for the 1st column header:

- HQLA High Quality Liquid Assets
- LCR Liquidity Coverage Ratio
- LCR-NCO Net Cash Outflows in the Liquidity Coverage Ratio denominator
- LCR-NCI Net Cash Inflows in the Liquidity Coverage Ratio denominator
- NSFR Net Stable Funding Ratio
- NSFR-ASF Available Stable Funding in the Net Stable Ratio numerator
- NSFR-RSF Required Stable Funding in the Net Stable Ratio numerator
- MT Monitoring Tools
- MT-CCFw Contractual Cash Flows in the Monitoring Tools
- MT-CFu Concentration of Funding in the Monitoring Tools
- MT-AUA Available Unencumbered Assets in the Monitoring Tools
- MT-MMT MT - Market Monitoring Tools
- MT-AI MT - Application Issues
- Gal General Topic

Topic	§ #	Comments
G ^{al}	7	Liquidity Supervisory Framework should be applied to all banks, not only to internationally active banking organizations. Otherwise, it would not contribute to the Level Playing Field. By the way, the crisis has shown that it affected at least as much non internationally active banking organizations (US Banks, Northern Rock were very home centric)
G ^{al}	9	This two layer approach makes very much sense and would help strengthening funding risk management in the banking industry to which this regulation will be applied to. Issues are in the details of the metrics' suggested set up. However, attention should be paid to make sure that banks are not competed by shadow banking industry that would not be subject to the same regulation. We urge banking supervisors to make sure the set up will cover the entire financial industry. As an example, regulators of various compartments of the money market should coordinate their efforts to ensure their framework do not compete against each other. The SEC proposals regarding money market funds are conflicting with banks' LCRs
G ^{al}	10	Though simpler to elaborate and certainly quicker to propose as a new regulatory framework, the one-size-fits-all approach that prevails for most of the parameters that are pre-determined in the CP fails to adapt to observed facts throughout the direst crisis in decades. The suggested parameters are useful as benchmark values. We suggest that they are used as default parameters from which the bank can depart from, provided that evidence based analysis justify it and the departure is agreed upon by the bank college of supervisors.
G ^{al}	10	The public disclosure of the regulatory standards (namely LCR and NSFR) is highly debatable and dangerous. Contrary to other public disclosures (market risk, counterparty risk...), the reader of the publicly disclosed information cannot change the position of the bank. This is completely different for funding

		<p>risk: the readers of the funding risk disclosure can have an immediate impact on the risk being disclosed.</p> <p>If not well understood, the public funding risk disclosure could actually increase funding and systemic risk (misunderstanding, false signals...).</p> <p>We recommend that disclosures are done to college of supervisors.</p>
LCR	11	The regulation will need to be more specific on the credit rating it refers to: short term or long term?
LCR	12	By definition, non-contractual contingent liabilities can <i>not</i> be listed!
MT	15	The contractual maturity mismatch is uninformative and misleading: core deposits would be considered overnight funding source even though this is the very role of the banking system (for centuries) to transform short term deposits into long term loans that the economy requires to thrive.
MT	15	When issuing negotiable debts, a bank cannot know which institution is holding its debts. The concentration by counterparties will not be applicable to negotiable instruments.
MT	15	The definition of "unencumbered" will need to be fine tuned since in the CP, it covers both "not funding-encumbered" (repo) and "not hedging-encumbered" (to hedge another financial instruments). When the hedge can be substituted by a future or any other derivative, it should not be considered "liquidity-encumbered", and consequently be considered "unencumbered" in the context of this paper.
G ^{al}	18	The regulation will need to be more specific on the credit rating it refers to: short term or long term?
G ^{al}	19	
LCR	20	The 100% threshold and the standardised calibrations that are being suggested don't take into account differences in intrinsic resiliency of the bank . The threshold and the calibration should be adapted to each bank,. criteria may need to be developed to lead to different thresholds and calibrations through an advanced approach as decribed in FBF proposal.
LCR	22	<p>If the stress is both idiosyncratic and market-wide, central banks should be considered part of the equation: central bank eligible assets should be considered in the liquidity buffer.</p> <p>Central banks' the role of lender of <i>last</i> resort role should not be confused with the lender of <i>first</i> resort. However, in a market wide stress test, central banks cannot simply be considered passive. Other incentives exist to safeguard their role while still authorising banks to use central bank facilities under extreme stress and when private markets for some asset types shut down.</p>
LCR	22	A 3-notches downgrade in 1 month is extreme: a 2 notches would be more evidence based. Which ratings are referred to, short or long term rating?
LCR	22	<p>The loss of secured funding should be evidence-based. Throughout the direst crisis in decades, equities have proved to remain liquid through direct sales or repo market.</p> <p>The binary approach should be substituted by a more progressive approach by asset class.</p>
LCR	22	g) The decisions taken to mitigate reputational risk should be very bank specific.
LCR	24	<p>As it is, the stress test scenario is quite extreme. Requiring even more severe stress test to be conducted internally would not add any value.</p> <p>The wording should suggest complementing with bank specific bank stress tests, not necessarily more severe, but testing other sources of vulnerabilities.</p>

		Sound liquidity management requires not to look for even more severe scenarios, but diverse and plausible scenarios.
HQLA	27	<p>The response to a market wide crisis cannot be to count on selling huge amounts of the very narrowly delimited so called High Quality Liquid Assets. It would make the crisis even deeper and would accelerate the propagation to an ever larger scope of banks.</p> <p>If a bank was to sale a bulk of so called High Quality Liquid Assets, it could be analyzed as wrongly signalling a liquidity crisis.</p> <p>The role of Central Banks in mitigating a market wide risk has to be articulated. Pledging assets to the Central Bank is clearly a better option in managing a market wide liquidity crisis.</p> <p>We recommend that Central Bank eligible assets are considered in the response to a market wide crisis: High Quality Liquid Assets should comprise both market-liquid assets and central bank eligible assets (" in order to qualify for "high-quality liquid asset", assets should be liquid in markets during a time of stress and, ideally, be central bank eligible " should be replaced by " in order to qualify for "high-quality liquid asset", assets should be liquid in markets during a time of stress or and, ideally, be central bank eligible ")</p> <p>In their capacity to modify the list of central bank eligible assets, and/or the haircuts, central banks would have a tool to defuse and manage liquidity crisis.</p> <p>Should the High Quality Liquid Assets remain as narrowly determined as in the current CP, the 1 month stress test scenario should be designed as a bank specific crisis.</p>
HQLA	27	<p>The more narrow the definition of Liquid Assets will be, the more demand for those assets will increase, which will have to be stuck in banks balance sheet, which will actually reduce their very liquidity they are selected for!</p> <p>There's a trade off between funding risk, that this CP is addressing, and asset illiquidity risk that needs to be carefully considered.</p> <p>The narrow definition of the buffer has a serious risk of dislocating cash and repo markets in these securities as they will be bought and held. As such, the qualification as liquid assets will render these securities less liquid.</p>
HQLA	27	<p>Asset liquidity is a function of the general risk aversion of the system at a given time. Asset "quality" generally helps but is hardly enough to guarantee liquidity at <i>all</i> times (the on the run 30yr Tbonds has once shown a 50bp spread to the off the run bonds). Central bank eligibility is an important driving factor to asset liquidity, even though it might not be a sufficient condition to guarantee seamless liquidity either (all participants do not access CBs).</p>
HQLA	29	<p>There is no rational for excluding equities from liquid assets that could be utilized in time of crisis: they should be allocated evidence based liquidity risk factor in both the LCR (cash inflows) and NSFR (lower required stable funding).</p>
HQLA	29	<p>What is the definition of "exotic"? Should inflation linked securities be excluded? Should US Agencies MBS and CMOs be excluded?</p> <p>Even for fixed rate government bonds, there are no "pricing formula".</p> <p>We recommend suppressing this constraint.</p> <p>Too much focus is put on the asset quality in the definition of liquid securities and too few on market infrastructure. E.g. Trading systems with netting, anonymous trading and linked with the Eurosystem have proved to be resilient</p>

		during the crisis also for securities which were no longer liquid in other private markets. An example is Eurex that has seen its volume of ECB eligible paper grow during the crisis. German banks can automatically pledge the collateral received in Eurex to the BuBa (it is the preferred route for the BuBa), while also investing cash without counterparty risk. This simple fact has safeguarded the liquidity in the system.
HQLA	29	<p>The statement that "assets issued by financial firms, for instance, are more likely to be illiquid in times of liquidity stress in the banking sector" needs to be facts-challenged. As an example, US Agency debts have <i>not</i> become less liquid.</p> <p>Through the exclusion of financials from the liquidity buffer, the market for financial bonds will become smaller and more expensive. At the same time will banks be forced to issue more LT funding to meet the LCR and NSFR requirements.</p>
HQLA	29	<p>The reference to "committed market makers" is welcome. It should be noted that, ironically, the current framework will disincentive market making for what the Basel Committee will not recognized as Liquid Assets.</p> <p>This is a chicken and egg issue: the narrower the definition of Basel Committee Liquid Assets, the less liquid the other assets will become; self-fulfilling the position of the Basel Committee... at the expense of market liquidity as a whole.</p>
HQLA	29	The more narrow the definition of Liquid Assets will be, the more concentrated the market for those securities will be!
HQLA	30	<p>The statement that "large sales [...] would generated mark-to-market losses for banks holding similar instruments and add to the pressure on their liquidity position" should lead the Basel Committee to</p> <ol style="list-style-type: none"> 1. acknowledge that High Liquid assets should be widened 2. central bank eligible assets should be considered as a response to a market wide crisis <p>Market liquidity is a situation-specific temporary feature, which by no means can be relied upon under all circumstances.</p>
HQLA	31	<p>It should be recognized that central bank eligibility contributes to asset liquidity: Central Banks are part of the equation.</p> <p>It should be noted that this benefits not only banks which have access to central banks, but the entire financial industry (asset management, insurance, corporate and retail client direct investments).</p> <p>In other words, central bank eligibility benefits the entire economy!</p>
HQLA	32	<p>The statement that "stock of liquid assets [...] should be managed with the clear and sole intent for use as a source of contingent funds" simply misses the point: what is important is to be operationally able to make those assets liquid in times of crisis in a delay lower than the considered stress horizon.</p> <p>This would reinforce the illiquidity that BCBS is counting on to mitigate a liquidity crisis!</p> <p>This requirement needs being suppressed.</p>
HQLA	33	<p>The key issue here is to be able to readily transfer liquidity from one currency / jurisdiction to where it is needed (other currency entity / other jurisdiction).</p> <p>The requirements to hold liquid buffer in each currency / jurisdiction simply denies both the available transfer mechanisms and the very existence of transnational banks.</p>

		Note that this is would lead to an uneven level playing field since the requirements would apply to local entities of internationally active banks, as if they were <i>not</i> part of a larger group, while they would not apply to local banks. We recommend not requiring to hold assets by jurisdiction / currency whenever liquidity can be readily transferred.
HQLA	33	A very important role of internationally active banks is to contribute to developing internationally active companies. If international active banks are limited in their international activities, international active companies would suffer in their development capabilities.
HQLA	33	Requiring banks to consider liquidity as trapped is self-fulfilling prophecy: the liquidity will actually be trapped; which would be at odds with the very objective of diversifying funding sources (notably diversifying currency funding sources) which is a sound liquidity risk management principle.
HQLA	33	Denying currency convertibility for the most highly convertible currencies would be too extreme a stress assumption.
HQLA	34	Central Bank eligible assets should be part of Liquid Assets that could be used as a response to a market wide stress test.
HQLA	34	The "0% risk-weight under Basel II standardised approach" criteria is not liquidity-based. Correlating credit risk to liquidity risk increase systemic risk (a credit risk crisis would more probably trigger a liquidity crisis if the liquidity buffer is reduced!) We suggest suppressing this constraint and replacing the definition of Liquid Assets by evidence based analyses.
HQLA	34	"The securities are not issued by banks or other financial services entities". What are the hard facts that lead to this exclusion? Would it exclude all US Agency Debts? all covered bonds? If retained, this constraint will dampen banks' funding sources (since they would have less "prudential"-value) at a time when the very same supervisor requires the banks to issue more and longer! This is a catch 22 situation. We suggest suppressing this constraint and replacing the definition of Liquid Assets by evidence based analyses.
HQLA	34	"d) government or central bank debt issued in domestic currencies by the country in which the liquidity risk is being taken <i>or the bank's home country</i> " What does the italic portion mean exactly ("or the bank's home country")? Notably for a trans-national bank? This should have a spill over effect on capital requirements: if recognized liquid, those securities should not require capital for credit risk.
HQLA	35	Why should a 50% limit exist? We suggest deleting this limit.
HQLA	36	In a market wide crisis, central bank eligibility should be a sufficient criteria to be considered a Liquid Assets in the LCR
HQLA	36	"Not issued by a bank, investment or insurance firm". What are the hard facts that lead to this exclusion? Would it exclude all US Agency Debts? all covered bonds? If retained, this constraint will dampen banks' funding sources (since they would have less "prudential"-value) at a time when the very same supervisor requires the banks to issue more and longer! This is a catch 22 situation. We suggest suppressing this constraint and replacing the definition of Liquid Assets by evidence based analyses.
HQLA	36	Other assets (CDs, CPs...) should be added to this section
HQLA	36	Correlating credit risk to liquidity risk increase systemic risk (a credit risk crisis

		would more probably trigger a liquidity crisis if the liquidity buffer is reduced!) We suggest suppressing this constraint and replacing the definition of Liquid Assets by evidence based analyses.
HQLA	36	The requirement on price (mark to market changes no bigger than 10%) to be considered a liquid assets is far too stringent, notably for emerging market securities or long dated government bonds {a 30 year Fixed Rate Bund would not be eligible since a "business as usual" change in rates' values (say 70bp) could change the Bund value by more than 10%}
HQLA	36	The requirement on bid ask (lower than 40bp / 50bp) to be considered a liquid assets is too stringent for emerging market securities.
HQLA	36	The different conditions for corporate bonds to be included in the 'stock of high quality liquid assets' are too severe as they basically exclude almost all corporate bonds: - liquid assets (at LCR numerator) are defined as including '36. Corporate bonds' that have to be '... at least AA (assigned a 20% haircut) ... ': are there any AA corporate bond remaining ? - the constraint for corporate bonds to have a 'proven ... liquidity in the markets (repo and sale) even during stressed market conditions ... ' does not mean anything and is not achievable - the condition on the maximum bid/ask spread for the pricing of the corporate bonds over a period of 10 years is also too severe as it will be impossible to reach for any corporate bond. Paragraph 36 results in excluding corporate bonds from the category 'high liquid assets', which will be damageable to the financing of the real economy, and will push towards a credit crunch.
HQLA	37	In a market wide crisis, central bank eligibility should be a sufficient criterion to be considered a Liquid Assets in the LCR.
HQLA	37	Excluding covered bond issued by the bank actually increases the systemic risk since it disincentives to increase the safety net that enables to increase the whole system resiliency to a market wide crisis. We suggest not excluding covered bonds issued by the bank itself. Other incentives can be created to avoid regular use of own-issued covered bonds at central banks. E.g. using a spread by the central bank to make its use more expensive would keep both the possibility to use it in extreme stress but avoid making the central bank the lender of first resort for these assets.
HQLA	37	Correlating credit risk to liquidity risk increase systemic risk (a credit risk crisis would more probably trigger a liquidity crisis if the liquidity buffer is reduced!) We suggest suppressing this constraint and replacing the definition of Liquid Assets by evidence based analyses.
LCR-NCO	40	"available at all times throughout the period" should not exclude the assets that are unencumbered at 1 month horizon (ex: liquid assets that are repoed for the next 15 days, or liquid assets that are used for intraday purposes).
LCR-NCO	41	The criteria that are used will require significant IT developments, before completion of which the final precise impact of the suggested regulation will have to be guesstimated
LCR-NCO	41	Is a collateralized deposit considered an insured deposit?
LCR-NCO	41	What does "effective" mean in "covered by an effective deposit insurance"?

LCR-NCO	41	Should deposits be broken down into its "insured portion" and its "uninsured portion"? (most insurance mechanisms have a insurance cap amount by depositors)
LCR-NCO	41	What will be the criteria to make sure that, across jurisdictions, insurance mechanisms are comparable?
LCR-NCO	42	Statistical methods should be authorized for allocation purposes to the BCBS categories.
LCR-NCO	45	Is collateral to financing/trade finance businesses excluded (CP mainly covers Capital Markets activities as far as collateral is concerned)? Such deposit collateral is stable since underlying assets are linked to the performance of underlying contracts is uncorrelated to a stressed environment in the financial markets or a material event to the borrowing institution.
LCR-NCO	46	<p>The criteria for "callability" should be refined. Funding sources may be callable based on market driven criteria (ex: called if the performance a stock index is higher than a specific threshold). The holder does not hold the option to call whenever he/she wants to. Call option may be owned by the issuer. The binary approach of the text to callable borrowings is too simplified.</p> <p>We suggest taking the call option into account through 3 cases:</p> <ol style="list-style-type: none"> 1. automatic option based on market driven criteria: run off assumptions should be dealt with the same approach as increase in collateral requirement in times of a crisis 2. call option owned by the holder: the runoff should be consistent with other borrowings from the same type of client 3. call option owned by the issuer: run off assumptions should be derived from reputation risk mitigation policy in a stress test scenario
LCR-NCO	48	The sentence "... effectively distinguishing between a "stable" portion of funding provided by small business customers and different buckets of less stable funding defined by each jurisdiction. " is not clear to us, especially the part that quotes "by each jurisdiction". Does this mean that each national supervisor can define what is stable and what isn't stable?
LCR-NCO	49	<p>What are the hard facts which justify that financial small business customers should be excluded from this category?</p> <p>We suggest not differentiating small financial business customers from other small business customers.</p>
LCR-NCO	49	The €1mm threshold should be replaced by a €10mm threshold
LCR-NCO	49	Summing amounts deposited from a same client in different products of the bank will require massive IT development before completion of which only guesstimates will be available.
LCR-NCO	51	<p>Other stickiness factors should be considered.</p> <p>What do non-financial corporate customers exactly mean? How are these customers defined? Would it be allowed to distinguish non-financial from financial corporate issuers by means of national activity codes (NACE)? What does "operational purposes" mean: is it to be compared to transactional accounts for retail purposes? The list of examples could include "accounts used by clients for the daily settlement of their securities transactions"</p>
LCR-NCO	51	What is the exact definition of "non-financial corporate customers"? Are UCITS included in the scope?
LCR-	54	What are the hard facts which justify such a dire 75% run off assumption for

NCO		<p>non financial corporate customers? This seems far too high compared to observations... even more so in a market wide crisis.</p> <p>Where will all those deposits go in a market wide crisis? The observation in the crisis was that some banks have benefited from a flight to quality.</p>
LCR-NCO	55	<p>What are the hard facts which justify such a dire 100% run off assumption for all other legal entity customers?</p> <p>Definitively, run off assumptions should be evidence based, with a granularity that enables to fine tune them across different type of depositors. Deposits from asset managers, from insurers, from broker dealers should not be the same, at 100%!</p> <p>We suggest working with supervisors on building up the breakdown and bank rating dependent runoff assumptions</p>
LCR-NCO	55	<p>Central Banks & Sovereign deposits would not be fully withdrawn if rating is not downgraded below single A, given official asset allocation.</p>
LCR-NCO	55	<p>The run-off factor of 100% is excessive because it disregards the operational relationship between the UCITS and the depositary bank : depositary banks offer to UCITS a wide range of services in the framework of a global depositary contract, among others : cash management / management of currency risk / management of securities transactions : control of settlement and delivery of the securities / securities lending or borrowing / management of security income including the tax aspects / providing real-time market information / providing real-time access to transactions and positions / reporting / selection and control procedures for sub-custodians / granting of credit lines for the UCITS. Such an operational link is a strong incentive for UCITS to maintain a stable relationship with their depositary bank. This is particularly true in times of stress because the operational experience gained by both parties facilitates a prompt reaction to adverse events and the proper and timely execution of the UCITS transactions.</p>
LCR-NCO	55	<p>In addition, the market practice shows that depositary banks benefit from a diversified customer base, so that their funding risk is split among a large number of UCITS. It is therefore highly improbable that all the UCITS (and their sponsors) decide simultaneously to cancel their contractual relationship with the depositary (and to close their cash accounts).</p>
LCR-NCO	55	<p>The run-off factor of 100% is excessive because it disregards the lessons drawn from the recent crisis. A majority of UCITS invest in high quality and liquid assets. Moreover, UCITS are subject to a mandatory diversification whereby no position held in the portfolio can exceed 10% of the total assets. These characteristics contribute to the liquidity of the UCITS and facilitate, in times of stress, the reimbursements to the shareholders who decide to redeem their shares. During the last crisis, we observed that some money market UCITS were submitted to significant shareholder's redemptions. In a first stage, the amount of cash held at the depositary banks decreased, but the run-off factor proved to be far below 100%. In a second stage, after having sold the corresponding proportion of assets, UCITS reconstituted their cash at their depositary bank. It was then observed that the amount of cash was roughly identical to the amount held before the crisis. In many cases, UCITS even increased the cash following the decision of the asset managers to adopt a more defensive investment strategy (more cash in the portfolio reduces the exposure to market risk)</p>
LCR-	56	<p>The runoff / roll over assumptions should be consistent over several products</p>

NCO		for the same type of customers / investors: there should be roll over assumptions for falling due notes/bonds and other debt securities.
LCR-NCO	57	Does the definition of "secured funding" mean that collateralized deposits from natural persons are considered like insured deposits?
LCR-NCO	58	<p>The no roll over assumption for non High Quality Liquid Assets (as defined in the present CP) is not backed by observations throughout the crisis. The repo market has played a significant and stabilizing role throughout the crisis. Denying those facts and requiring funding for assets which have benefited from an active repo market would actually lead to decrease the repo market, decreasing the liquidity of those assets.</p> <p>This is notably the case of equities.</p> <p>This suggestion denies the development of tri party repos which enable to decouple the borrower from the lender and have proved to be very resilient throughout the crisis.</p> <p>We urge the BCBS to reconsider this groundless extreme position which ignores facts and propose to work on a breakdown of assets benefiting from a strong repo market and their runoff factors.</p> <p>'Loss of secured funding on short term financing transactions': it is not obvious that we do roll-over all maturing repo on high liquid assets, as we may want to get back as much cash as possible: we are discussing here the symmetrical approach. Moreover, we have to take into account the reason why we run those operations: the reality is less systematic than saying that all repo on high liquid assets will be renewed whereas all repo on none liquid assets will not be renewed.</p> <p>Moreover, considering that no rollover for repo on non (narrowly defined) high liquid assets is too conservative</p>
LCR-NCO	59	The table needs to breakdown in smaller categories with evidence based runoff assumptions
LCR-NCO	59	<p>Correlating credit risk to liquidity risk increase systemic risk (a credit risk crisis would more probably trigger a liquidity crisis if the liquidity buffer is reduced!)</p> <p>We suggest suppressing this constraint and replacing the definition of Liquid Assets by evidence based analyses.</p>
LCR-NCO	61	A 3-notches down grade in 1 month is extreme: a 2-notches would be more evidence based. Which ratings are referred to, short or long term rating?
LCR-NCO	63	The 20% increase in collateral requirement needs to be lowered and adapted to the posted collateral.
LCR-NCO	64-65	<p>Insofar as the text refers to the consolidated group, what are the conduits that are referred to? The borrowings for consolidated conduits would be dealt with at the group level (ie §41-§63).</p> <p>If the conduits are not consolidated, they should affect the group to the extent of either the committed funding contract between the bank and the conduits; or the reputation risk.</p> <p>We suggest dealing with ABCP fundings consistently with other fundings in the text, not stigmatizing ABCP on its own. Even during the worst moments of the last crisis, the ability to fund conduits has never completely disappeared. Some of the conduits kept the capacity to fund themselves through placement to clients at 100%.</p> <p>By the way, it shows that there is a need to have a consistent supervisory framework across the entire financial industry.</p>
LCR-	66	The "conditionally revocable agreements to extend funds in the future" should

NCO		be excluded when the conditions relate to a bank specific or a market wide crisis: liquidity regulation has to be consistent with legally binding commitments.
LCR-NCO	66	The requirement: "Therefore, for purposes of this stress test, all facilities that are assumed to be drawn [...] will remain outstanding at the amounts assigned throughout the duration of the test, regardless of maturity", extends banks' commitments beyond what is legally binding: this is inconsistent. We recommend that the contractual maturity should be taken into account.
LCR-NCO	66	There is no evidence that during a bank specific and market wide crisis, retail clients would draw their committed lines from the bank. We recommend substituting 5% conservative drawdown assumptions to the too severe and groundless drawdown assumptions for retail clients.
LCR-NCO	66	The 100% drawdown assumptions for (c) and (d) are groundless and deny what has been observed during the crisis. By being unduly punitive in those drawdown assumptions, banks would be led not to offer this type of products. At the end, the risk would reside in our customers which would not be equipped to face those adverse circumstances.
LCR-NCO	66	66(d) – 76: Asymmetric treatment of liquidity lines : all lines granted to financial institutions are drawn but all lines obtained have no liquidity value. Liquidity regulation has to be consistent with legally binding commitments.
LCR-NCO	66	Insurance companies should be perceived as corporate customers: facilities in place are intended to cover regulatory needs to operate, and are mostly used in a L/C form; and insurance companies are naturally long cash.
LCR-NCO	66	Revolving Credit Facilities (given their general corporate purpose component, and their utilization by borrowers to cover working capital needs) and other OBS commitments linked to the financings of specific projects/assets (for instance, 'facilities arranged for Trade Finance purpose') should be explicitly excluded from 'liquidity facilities'. 'Liquidity facilities' should be clearly defined as committed lines which utilization is expressly linked to the inability of the borrower to access specific capital markets' funding sources (such as CP back-up lines).
LCR-NCO	66	Liquidity facilities: in a LCR short-term perspective, expected drawdown rate are correlated to short term rating of the borrower, given evidence of correlation amongst rating bucket in normal times and confirmed during the recent crisis. For instance, drawdown rates for borrowers which short-term ratings were A1/P1 have remained below 10% during the 6-month following Lehman collapse.
LCR-NCO	66	This should not apply to intraday committed facilities?
LCR-NCO	67	Requiring the bank to be committed to non legally binding commitments is beyond the scope of liquidity regulation.
LCR-NCO	69	Undrawn uncommitted facilities: should be excluded from LCR given banks' capacity to monitor those lines where no contractual obligations exist during extreme stress scenarii (highly evidenced during recent events).
LCR-CI	71	Equities and other assets (CDs, CPs...) should be added to this section
LCR-CI	76	The assumption not to consider lines of credit is at odds with contractual obligations, and consequently extends the banks' commitments beyond what is legally binding. We recommend to including lines of credit in the cash inflows. Should the lines of credit be ignored, it would disincentive entering into such

		products, which would make the system more fragile.
NSFR	78	A 1 year long stress test scenario needs to take into account the counterbalancing action of the bank during such an extended crisis. The bank cannot be assumed to run a business as usual approach during such a long crisis. Scale-down assumptions should be considered.
NSFR	80	Trading activities are among the easiest to scale down in a stress test scenario. The requirement to long term fund the stock of trading assets as of the beginning of the stress test, all over the 1 year long stress test period, is not consistent with actions that would be taken, should such a crisis occur.
NSFR	80	The definition of liquid assets for the NSFR need not coincide with the liquid asset for the LCR. As it is market wide crisis based, the LCR liquid assets should comprise both short term market liquid assets and central bank eligible assets. As it is bank-specific crisis related, the NSFR liquid assets could be limited to assets that can be liquid within 1 year horizon.
NSFR-ASF	82	What does "effective maturity" mean exactly?
NSFR-ASF	86	What are "all other liabilities"? Is this an accounting view of other liabilities, or is it an instrument perspective? It should indeed be an instrument view instead of an accounting view. According to the current text, accruals to receive which are by nature short maturity would have to be fully financed with long term funding. With regard to the calculation of tier 1; isn't there a double-counting of e.g. goodwill and intangibles which may be weighted 100% at the asset side ("all other assets" read from a general ledger perspective) and at the same time deducted from tier 1 capital?
NSFR-ASF	86	Repo that matures within 1 year should be given a roll over assumptions by type of assets since the capacity to repo assets will not be cancelled out in a bank specific stress test.
NSFR-ASF	86	The no roll over assumption for non High Quality Liquid Assets (as defined in the present CP) is not backed observations throughout the crisis. The repo market has played a significant and stabilizing role throughout the crisis. Denying those facts and requiring funding for assets which have benefited from an active repo market would actually lead to decrease the repo market, decreasing the liquidity of those assets. This is notably the case of equities. This suggestion denies the development of tri party repos which enable to decouple the borrower from the lender and have proved to be very resilient throughout the crisis. We urge the Basel Committee to reconsider this groundless extreme position which ignores facts and propose to work on a breakdown of assets benefiting from a strong repo market and their runoff factors.
NSFR-ASF	86	Cf §55.
NSFR-RSF	89	What does "effective" mean in "securities with effective remaining maturities of less than one year"? We suggest that it enables to capture the date at which the securities are estimated to be sold in a bank specific stress test, or the expected maturity of cash inflows for loans when considering expected prepayments.
NSFR-RSF	89	The RSF Factors should be evidence based. The 20% RSF for corporate and covered bonds and 50% RSF factor for equities are at odds with actual evidence. The RSF Factors should be derived from

		observed repo haircut.
NSFR-RSF	89	The 50% roll over assumptions for non-financial corporate clients having a residual maturity of less than one year does not make sense when considering a bank specific crisis. It assumes that the bank would not scale its loan origination business in such a long stress test period.
NSFR-RSF	89	The 85% roll over assumptions for retail clients having a residual maturity of less than one year does not make sense when considering a bank specific crisis. It assumes that the bank would not scale its loan origination business in such a long stress test period.
NSFR-RSF	89	What are the "all other assets"? Are they derived from an accounting perspective or from a cash instrument perspective (which we recommend)? As an example, if considered from an accounting perspective the derivatives mark to market on the asset side of the balance sheet would require Net Stable Funding if contributing to the 100% RSF Factor attached to "all other assets". Not that this would lead to non manageable liquidity position since the value of derivatives is varying over time, and may switch from the asset side (when they have positive values) to liability side (when they have negative values)
NSFR-RSF	89	For facilities with initial maturity below 1-year linked to the financing of a specific asset/delivery (ex: Commodity Finance), no roll-over assumptions should be made given banks' capacity to limit/not renew in extreme cases those exposures with limited franchise risks.
NSFR-RSF	89	For facilities linked to a specific project (short to long term): no roll-over assumptions should be considered given uncertainty new projects materialise within 1-year and that opportunity flow for such new financings is not linear.
NSFR-RSF	91	The 10%-drawdown assumption on off balance sheet assumption is severe given that we consider an idiosyncratic event (ie what rationale for massive drawdown increase?).
NSFR-RSF	91	Uncommitted credit and liquidity facilities should not lead to liquidity requirement since they are not legally binding.
MT-CCFw	95	It is essential that the Contractual Cash Flow Mismatch is disclosed only to supervisors, since it would be highly misleading to disclose to non liquidity expert public. By the way, it is redundant and far less informative than with the LCR and NSFR (once recalibrated)
MT-CFu	105	It is impossible to know which institution / which individual owns a negotiable debt instruments, or brokered deposits.
MT-CFu	107	The total balance sheet is not a relevant balance to consider in a funding risk metric since the accounting entries are not driven by funding / liquidity. As an example, as IFRS requires derivatives to be accounted for their fair value, a perfectly matched position with two offsetting swaps would increase both side of the balance sheet (one of the swap would be accounted for an asset for its fair value, while the other swap would be accounted for a liability for the opposite fair value).
MT-CFu	112	Should expected or contractual maturities be considered to time bucket assets and liabilities?
MT-AI	132	The monthly frequency and the 2 weeks maximum lag to report LCR and NSFR are inconsistent with reconciling balances with financial statements. FBF suggests aligning the frequency and lag on those applicable to financial statement disclosure.
MT-AI	133	The application scope should be at consolidated level, as suggested by BCBS CP.

MT-AI	134	The sentence “ <i>Banks and supervisors cannot assume that currencies will remain transferable in a stress, even for currencies which in normal times are highly convertible</i> ” may be interpreted by supervisors such as to require LCR and NSFR to be met for each currency. Convertibility shutdown for usually highly convertible currencies would be far too extreme an assumption.
MT-AI	135	The right tradeoff should be looked for between public disclosure and the increase in funding risk it fosters.

APPENDIX D: ADVANCED LIQUIDITY RISK MEASUREMENT FRAMEWORK

The BCBS proposals on liquidity supervision focus on standardized metrics which cannot apply to banking institutions well diversified in terms of activities, currencies, subsidiaries.

In total consistency with the French Secrétariat Général of Commission Bancaire⁴'s approach, FBF suggests creating two different regulatory measurement regimes:

- a standard regime, based on standardized liquidity risk measurement framework (LCR, NSFR risk metrics). This would be an adapted framework for the simplest, homogeneous institutions,
- an advanced regime, based on advanced set up of risk metrics. This would be adapted a framework for diversified banks.

Contrary to credit risk assessment models, an advanced liquidity risk management framework is not a mathematical model; it is a complete set up of information, management and governance, based on compliance with a set of rules which enable Supervisors checking that liquidity risk is thoroughly assessed, and monitored cautiously.

This approach includes the following strong points:

- It is based on risk simulation, and starts from liquidity stress tests, leading to a definition of the liquidity buffers which will allow the bank to withstand a liquidity crisis over a given period of time
- It ensures a full convergence between regulatory reporting, and management methodologies, which guarantees an all-time compliance with regulatory standards
- It makes Supervisors fully informed of all components of internal liquidity management, and enables them to assess the quality of information and management systems
- It requires a total commitment from General Management (Executive Committee, Board) who are directly responsible for the main decisions regarding liquidity policy (liquidity buffers, gapping limits, diversification, internal transfer pricing...)
- It outlines the Governance set up and rules implemented by the bank
- It fits the specificities of the bank's business model, which cannot be obtained through a standardised set of risk metrics.

An advanced set up of liquidity management is always subject to prior audit and validation by a Regulator.

For a multinational bank, the *home* supervisor is responsible for this audit and validation process. *host* supervisors are informed through the College of Supervisors set up for each relevant banking institution.

⁴ French supervisor

APPENDIX E: SUGGESTED CHANGES TO THE STANDARDIZED LCR AND NSFR

GUIDING PRINCIPLES FOR THE SUGGESTED CHANGES:

The guiding principles for FBF suggestions for changes in LCR and NSFR assumptions sets are described below:

- LCR and NSFR should be considered in combination:
 - NSFR addresses the liquidity position at 1 year horizon.
 - Considering the NSFR, which enables a sound term liquidity position, LCR is designed to make sure the bank is able to resist a severe stress test on a one month horizon
- NSFR is derived from a 1 year long idiosyncratic liquidity stress test scenario
 - Central Bank eligibility is *not* a criterion, *per se*, for NSFR-liquidity
 - Unsecured funding sources are assumed to decrease but not completely disappear (notably, not all interbank funding is assumed to vanish)
 - NSFR should be consistent with the transformation function of the banking industry, notably through the lower than 100% threshold that will be chosen
 - NSFR should embed the bank's expected reactions / changes in its business models in such an extended stress scenario. This can be represented by breaking down asset generating businesses into "ongoing concern businesses" (that can be partially scaled down) and "non ongoing concern business" (that can be completely stopped in a crisis)
 - NSFR should embed the bank's expected prepayment on loans
 - Consistency should be ensured between assumed decrease in funding sources and assumed roll over assumptions (ex: the higher the runoff for interbank funding source, the lower the rollover assumptions for loans)
- LCR is derived from a 1 month market-wide and idiosyncratic liquidity stress test scenario:
 - Central Banks are part of the crisis management process and Central Bank eligible assets are considered liquid assets⁵
 - The severity of stress assumptions has to be revised down to be consistent with observed facts in the direst crisis in decades
- Liquid assets are evidence-based-derived and take into account sell-ability, repo-ability and market infrastructure (ex: repo exchanges, tri-party repo). As the underlying stress scenarios are different, LCR-liquid assets and NSFR-liquid assets are different.
- Symmetry should apply to similar assets and liabilities (ex: drawdown assumptions)
- Deposit stickiness and loans' rollover should derive from both relationship and customer / counterparty type. As an example, a deposit from a financial institution to which the bank has an ongoing strong relationship should be considered stickier than a deposit from a financial institution without such an ongoing relationship.
- "Financial institution" category needs being broken down in more granular categories
- To cope with volatile balances, average balances, over relevant periods, could be used.
- Statistical methods can be utilized to map transactions to the pre-determined categories
- Foreign exchange convertibility is unchanged for NSFR (idiosyncratic stress-based). Highly liquid and convertible currencies in normal times remain liquid and convertible for LCR.
- Assumption sets should be consistent with legally binding commitments.

⁵ NSFR requires that non liquid securities need term funding. The combination of both NSFR and LCR makes sure that the central bank eligibility is not used not to term fund those assets. By the way, this is the NSFR term funding requirements that makes sure that central bank eligibility is a liquidity buffer (ie: that it delivers additional liquidity).

- The assumptions to apply to transactions, pools of transactions or balance sheet accounts that are not explicitly covered by the LCR- or NSFR-assumption sets could be agreed upon with the relevant supervisor (local supervisor for local issues, college of supervisors for global issues).
- Other assumptions will be needed to cover the entire balance sheet. A combination of standardized assumption set for all, and local supervisor adaptation.
 - Regularization accounts on both sides of the balance sheets do not necessarily relate to funding issues. They should not be allocated a 100% overlay factor in the required funding ratio, and a 0% overlay factor in the available funding ratio.
 - Derivatives accounted for as assets (ex: bought options and swaps with positive values) should not be considered as requiring 1 year term funding for their value. Conversely, derivatives accounted for as liabilities (ex: written options and swaps with negative values) should not be considered an available funding source.

FBF suggests working with the BCBS on fine tuning NSFR/LCR assumption sets that would apply to the standardized regime.

SUGGESTED CHANGES TO NSFR ASSUMPTION SET:

FBF concurs with 1 year liquidity risk metrics. However, as it is bank-specific stress test based, it should embed the expected changes in business model that would necessarily take place over such an extended stress scenario.

As the liquidity maturity transformation is the role of banks in the economy, we suggest a threshold that would range from 80%. Supervisors could increase the threshold to a higher level, based on the analyses they would do. That would help complementing a highly standardized framework with a judgemental approach that could appreciate the intrinsic strengths of the bank being considered.

FBF suggests:

$$\frac{\text{Available Stable Funding}}{\text{Required Stable Funding}} \geq 80\% + \text{supervisor add-on}$$

FBF suggests working with the Basel Committee on striking the right balance between the required NSFR threshold and the underlying NSFR assumption set.

A possible assumption breakdown is presented in the tables below. Those assumptions could be elaborated further so as to ensure consistency between the runoff and rollover assumptions. As an example, the most severe the runoff on interbank funding source will be, the lower the rollover assumptions of loans maturing in the next year should be.

Nota Bene for the tables below:

- Unencumbered assets: The encumbrement should be assessed consistent with the 1 year horizon (an asset that is repo for the next 10 days, is unencumbered at 1 year horizon). Assets held as hedges (e.g. equities held as delta hedge) should not be considered as encumbered. E.g. if liquid, they could be repo'd or sold and replaced by futures or other derivatives. Assets collateralising a transaction should only be considered as encumbered if the bank cannot freely dispose of them : e.g. assets given in pledge as collateral. Among others, assets received as collateral which the bank has the right to re-use shall not be considered as encumbered.
- Time Deposits include debt instruments
- For liability, the maturity to consider is the minimum between the contractual maturity and the first call date when the call is owned by the lender
- Fiduciaries here do not cover direct deposits from clients, which should be allocated to retail deposits' runoff assumptions
- Balances to report are at 1 year horizon and embed prepayments / calls that are expected over the next 12 months
- For off balance sheet commitments, credit facilities and liquidity facilities, only the ones with greater than 1 year contractual maturities are considered.

A loan origination business is stoppable subject to the following criteria: 1. it is loan-origination focused; 2. it does not collect resources from the same type of client it originates loans to; 3. it is not essential to the bank's profitability.

Available Stable Funding			
Counterpart	Instruments	Breakdowns	Overlay Factors ⁶
Shareholder	Capital	Tier 1 + Tier 2	100 %
		Non Tier 2 preferred stock with maturity ≥ 1 y	100 %
Retail, Small Business, Custodian	On demand Deposits, or Time Deposits with Small Penalty (whatever the term)	Insured or secured or relationship	85 %
		Other	70 %
	Time Deposits with High Penalty	≥ 1 y	100 %
		< 1 y Insured or secured or relationship	85%
		Other	70%
Corporate, Public Administrations	Deposits on Demand	Insured or secured or relationship	60 %
		Other	20 %
	Time Deposits	≥ 1 y	100 %
		< 1 y Insured or secured or relationship	60%
		Other	20%
Asset Managers, Brokers/Dealers, Money Market, Insurance, Fiduciaries, Beneficiaries.	Deposits on Demand	Insured or secured or relationship	50 %
		Other	0 %
	Time Deposits	≥ 1 y	100 %
		< 1 y Insured or secured or relationship	50%
		Other	0%
Central Banks, Banks	Deposits on Demand	Insured or secured or relationship	25%
		Other	0%
	Time Deposits	≥ 1 y	100 %
		< 1 y Insured or secured or relationship	25%
		Other	0%

⁶ **Overlay factors** should be interpreted dependent on the instruments they are applied to. For non maturing instrument, such as demand deposit, they represent the outstanding portion of balances that is expected to remain at the considered horizon (ex: retail demand deposit 85% amounts to 15% runoff). For instruments with a contractual maturity lower than 1 year, it represents a rollover assumption (ex: 85% retail CD rollover). For instruments with a contractual maturity higher than 1 year, a lower than 100% overlay factor represents the portion that is assumed to be prepaid (asset) or called (liability) before contractual maturity (ex: longer than 1 year retail CD are assumed to be prepaid for a 15% portion)

Available Stable Funding (Cont'd)					
Counterpart	Instruments	Breakdowns		Overlay Factors	
SPVs, ABCP, conduits	Deposits on Demand	Insured or secured or relationship		0%	
		Other		0 %	
	Time Deposits	≥ 1 y		100 %	
		< 1 y	Insured or secured or relationship		0%
			Other		0%
Capital Market	Repo < 1 y	Repo ≥ 1 y		100%	
		Debt	Government (G20)		95%
			PSE's (G20)		90%
			Covered Bonds (G20)		80%
			Investment Grade Corporate + Non G20 Government Bonds		70%
			Corporate High Yield		60%
			Other		50%
			Equities	Major stock indices	≤ 5% Mkt Cap ⁷
		> 5% Mkt Cap			80%
		ETFs		60%	
		Other		50%	
	Other Liabilities			Local Supervisor	

⁷ Mkt Cap = Market Capitalization.

Required Stable Funding				
Counterpart	Instruments	Breakdowns		Overlay Factors
Retail, Small Business, Custodian	Loans	≥ 1 y		100 %
			< 1 y	Stoppable business
				Other
	Credit and Liquidity Facilities ≥ 1 y		Credit Facility	2.5%
			Liquidity Facility	
			Other	Local supervisors
Corporate, Public Administrations	Loans	≥ 1 y		100 %
			< 1 y	Stoppable business
				Other
	Credit and Liquidity Facilities ≥ 1 y		Credit Facility	2.5%
			Liquidity Facility	5%
			Other	Local supervisors
Asset Managers, Brokers/Dealers, Money Market, Insurance, Fiduciaries, Beneficiaries.	Loans	≥ 1 y		100 %
			< 1 y	Stoppable business
				Other
	Credit and Liquidity Facilities ≥ 1 y		Credit Facility	2.5%
			Liquidity Facility	5%
			Other	Local supervisors
Central Banks, Banks	Loans	≥ 1 y		100 %
			< 1 y	Stoppable business
				Other
	Credit and Liquidity Facilities ≥ 1 y		Credit Facility	5%
			Liquidity Facility	10%
			Other	Local supervisors
SPVs, ABCP, conduits	Loans	≥ 1 y		100 %
			< 1 y	Stoppable business
				Other
	Credit and Liquidity Facilities ≥ 1 y		Credit Facility	5%
			Liquidity Facility	10%
			Other	Local supervisors

Required Stable Funding (Cont'd)					
Counterpart	Instruments	Breakdowns		Overlay Factors	
Capital Market	Unencumbered Assets	Debt	Government (G20)		5%
			PSE's (G20)		10%
			Covered Bonds (G20)		20%
			Investment Grade Corporate and Non G20 Government bonds		30%
			Corporate High Yield		
			Other		
		Equities	Major stock indices	< 5% Mkt Cap	10%
				< 25% Mkt Cap	20%
				ETFs	40%
				Other	50%
	Reverse Repo < 1 y	Reverse Repo ≥ 1 y		100%	
		Debt	Government (G20)		95%
			PSE's (G20)		90%
			Covered Bonds (G20)		80%
			Investment Grade Corporate + Non G20 Government Bonds		70%
			Corporate High Yield		
			Other		50%
		Equities	Major stock indices	≤ 5% Mkt Cap ⁸	90%
				> 5% Mkt Cap	80%
				ETFs	60%
				Other	50%
Other	Off balance sheet commitments	Guarantees		Local Supervisor	
		Letters of credit			
		Trade Finance			
		Premises, Furniture & Equipments		100%	
		Strategic Investments		100%	
Other Assets				Local Supervisor	

⁸ Mkt Cap = Market Capitalization.

SUGGESTED CHANGES TO LCR ASSUMPTION SET:

FBF concurs with a *market-wide* and *idiosyncratic* stress test-derived one month liquidity risk metrics.

Due to its *market-wide* component, central banks (CB) are necessarily active managing stakeholders in such a crisis, notably to avoid spill-over and vicious circle effects. Consequently, all central bank eligible assets should be considered as building up the liquidity buffer that may be used to mitigate the crisis. The eligible assets and the haircuts that will be used are central bank specific and vary over time. That's why the table below is a template that should be adapted to each central bank's eligibility criteria and applicable factors as of calculation date (ie: changes in eligibility criteria will impact liquidity buffer, which give central bank an additional tool to lean on liquidity risk management).

In order to include eligible assets in the liquidity buffer, banks should demonstrate that they have the operational processes to actually readily pledge the eligible assets to each Central Bank.

The liquidity buffer could also comprise assets that could be readily liquidated on capital markets through either sales or repurchase agreements. The assets that are considered liquid through capital markets should not be considered in the Cash Inflows to avoid double counting.

Counterpart	LCR-Liquidity Buffer		Liquidity Factor
	Unencumbered Assets	Other	
Central Banks (CB)	CB eligible unencumbered Debts...		CB-specific haircuts
	CB eligible unencumbered Loans		
	CB eligible unencumbered Equities		
Capital Markets sellability or repoability in times of market wide stress scenario	Non Central Bank-eligible unencumbered liquid debts	Government (G20)	90%
		PSE's (G20)	80%
		Covered Bonds (G20)	70%

The table below shows the suggestions for cash outflows:

Cash Outflows			
Counterpart	Instruments	Breakdowns	Overlay Factors
Retail, Small Business, Custodian	On demand Deposits, or Time Deposits with Small Penalty (whatever the term)	Insured or secured or relationship	7.5 %
		Other	15 %
	Time Deposits with High Penalty	≥ 1 m	0 %
		< 1 m Insured or secured or relationship	7.5 %
		Other	15 %
	Credit and Liquidity Facilities	Credit Facility	2.5%
		Liquidity Facility	Local supervisors
Corporate, Public Administrations	Deposits on Demand	Insured or secured or relationship	20 %
		Other	40 %
	Time Deposits	≥ 1 m	0 %
		< 1 m Insured or secured or relationship	20 %
		Other	40 %
	Credit and Liquidity Facilities	Credit Facility	5%
		Liquidity Facility	20%
Asset Managers, Brokers/Dealers, Money Market, Insurance, Fiduciaries, Beneficiaries.	Deposits on Demand	Insured or secured or relationship	25 %
		Other	50 %
	Time Deposits	≥ 1 m	0 %
		< 1 m Insured or secured or relationship	25 %
		Other	50 %
	Credit and Liquidity Facilities ≥ 1 m	Credit Facility	5%
		Liquidity Facility	30%
Central Banks, Banks	Deposits on Demand	Insured or secured or relationship	50 %
		Other	100 %
	Time Deposits	≥ 1 m	0 %
		< 1 m Insured or secured or relationship	50 %
		Other	100 %
	Credit and Liquidity Facilities ≥ 1 m	Credit Facility	10 %
		Liquidity Facility	50%
		Other	Local supervisors

Cash Outflows (Cont'd)				
Counterpart	Instruments	Breakdowns		Overlay Factors
SPVs, ABCP, conduits	Deposits on Demand	Insured or secured or relationship		50 %
		Other		100 %
		≥ 1 m		0 %
	Time Deposits	< 1 m	Insured or secured or relationship	20%
			Other	100%
		Credit Facility		10%
	Credit and Liquidity Facilities ≥ 1 m	Liquidity Facility ⁹		100%
		Other		Local supervisors
Capital Market	Repo < 1 m	Repo ≥ 1 m		0%
		Debt	Government (G20)	10%
			PSE's (G20)	20%
			Covered Bonds (G20)	30%
			Investment Grade Corporate, non G20	50%
			Government	
			Corporate High Yield	75%
			Other	100%
		Equities	≤ 5% Mkt Cap	50%
			>5% Mkt Cap	60%
			ETFs	60%
			Other	75%
		Other		100%

⁹ For sponsored conduits, we suggest a look through approach: the 100% should apply to the assets in the conduits, net of greater than 1 month conduits borrowings (including the rollover assumptions on lower than 1 month conduits' borrowings)

Cash Outflows (Cont'd)					
Counterpart	Instruments	Breakdowns		Overlay Factors	
Other	Downgrade triggers			100%	
	Increased of posted collateral calls from changes on derivative transactions, and decrease of received collateral			100%	
	Increased liquidity needs related to valuation changes on posted collateral securing derivative transaction	Posted Debt instruments	Government (G20)	5%	
			PSE's (G20)	5%	
			Covered Bonds (G20)	10%	
			Investment Grade Corporate, non G20 Government	10%	
			Corporate High Yield	15%	
			Other	15%	
		Posted Equities	Major stock indices	≤5% Mkt Cap	20%
				>5% Mkt Cap	20%
				ETFs	20%
				Other	20%
			Other		20%
	Contingent Liabilities			100%	
	Cash Outflows	Ex: contractual cash outflows on derivatives		100%	
	Other	Guarantees		Local Supervisor	
		Letters of credit			
		Trade Finance			
Other			Local Supervisor		

NB:

- Time Deposits include debt instruments
- For a liability, the maturity to consider is the minimum between the contractual maturity and the first call date when the call is owned by the lender
- Unencumbered assets :
 - The encumbrance should be assessed consistent with the 1 month horizon (an asset that is repo for the next 10 days, is unencumbered at 1 month horizon)
 - assets held as hedges (e.g. equities held as delta hedge) should not be considered as encumbered. E.g. if liquid, they could be repo'ed or sold and replaced by futures or other derivatives.
 - assets collateralising a transaction should only be considered as encumbered if the bank cannot freely dispose of them : e.g. assets given in pledge as collateral. Among others, assets received as collateral which the bank has the right to re-use shall not be considered as encumbered.
- Fiduciaries here do not cover direct deposits from clients, which should be allocated to retail deposits' runoff assumptions

- Liquidity facility that would lead to central bank eligible loans if drawn, could be allocated a more favourable overlay factor.

The relationship should be based on judgement, reviewed and challenged by college of supervisors. The examples of such relationships that can render deposits sticky are valid examples that should not be seen as excluding other possibilities. The table below shows a few examples:

Examples of stickiness factors	
Retail	Accounts where salaries are automatically credited
	...
Institutions	Cash management or other administrative funds relationship
	Legally binding commitment to collateralize a loan with deposit (for all or portion of the loan balances or loans' expected cash flows).
	Legal commitment to deposit in the bank that cannot be unwound in 1 month (ex: deposits from custodian)
	Capital ownership between the institution and the bank
All	...
	Deposits covered by an insurance mechanism
	Deposits collateralized with loans/securities
	Length of the relationship between the client and its bank: the longer and the deeper the relationship, the stickier it could be expected.
	Number of services with the customer (deposits, loans, credit/debit card
	...

The table below shows the LCR assumption for cash inflows:

Counterpart	Instruments	Cash Inflows	
		Breakdowns	Overlay Factors
All	Performing Loans	with contractual maturities	100% ¹⁰
		without contractual maturities ¹¹	0%
Capital Markets sellability or repoability in times of market wide stress scenario	Unencumbered Liquid Debts (not included in the buffer)	Government (G20)	100%
		PSE's (G20)	80%
		Covered Bonds (G20)	70%
		Investment Grade Corporate, non G20 government	50%
		Corporate High Yield	25%
		Other	0%
	Unencumbered Liquid Equities	Major stock indices Mkt Cap ≤ 5%	50%
		Major stock indices Mkt Cap > 5%	40%

¹⁰ This means that no loan rollover is assumed, what is consistent with the BCBS CP. In the discussion that FBF is willing to have with BCBS, the no loan rollover assumption could be reviewed, in light of what FBF suggests for NSFR: stoppable loan businesses could be allocated a specific overlay factor.

¹¹ Overdraft is an example of loan without contractual maturity. The 0% suggested overlay factor is very conservative.

	ETF	40%
	Other	0%

Cash Inflows (Cont'd)			
Counterpart	Instruments	Breakdowns	Overlay Factors
Capital Market	Reverse Repo < 1 m	Reverse Repo \geq 1 m	0%
		Government (G20)	90%
		PSE's (G20)	80%
		Covered Bonds (G20)	70%
		Debt	
		Investment Grade Corporate, non G20 Government	50%
		Corporate High Yield	25%
		Other	0%
		Equities	
		Major stock indices	
		≤ 5% Mkt Cap	50%
All	Cash, Money Market Instruments	> 5% Mkt Cap	40%
		ETFs	40%
		Other	25%
		Other	0%
Other	Bought Liquidity Facilities		Symmetric to Sold Liquidity Facilities
	Cash Inflows Ex: Contractual cash inflows on derivatives		Symmetric to Deposits
Other	Decrease of posted collateral from changes on derivative transactions, and increase of received collateral		100%
	Other		Local Supervisor

APPENDIX F: “PRINCIPLES FOR SOUND LIQUIDITY RISK MANAGEMENT AND SUPERVISION”
BASEL COMMITTEE ON BANKING SUPERVISION – SEPTEMBER 2008
(<http://www.bis.org/publ/bcbs144.pdf>)

FUNDAMENTAL PRINCIPLE FOR THE MANAGEMENT AND SUPERVISION OF LIQUIDITY RISK

Principle 1: A bank is responsible for the sound management of liquidity risk. A bank should establish a robust liquidity risk management framework that ensures it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets, to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources. Supervisors should assess the adequacy of both a bank's liquidity risk management framework and its liquidity position and should take prompt action if a bank is deficient in either area in order to protect depositors and to limit potential damage to the financial system.

GOVERNANCE OF LIQUIDITY RISK MANAGEMENT

Principle 2: A bank should clearly articulate a liquidity risk tolerance that is appropriate for its business strategy and its role in the financial system.

Principle 3: Senior management should develop a strategy, policies and practices to manage liquidity risk in accordance with the risk tolerance and to ensure that the bank maintains sufficient liquidity. Senior management should continuously review information on the bank's liquidity developments and report to the board of directors on a regular basis. A bank's board of directors should review and approve the strategy, policies and practices related to the management of liquidity at least annually and ensure that senior management manages liquidity risk effectively.

Principle 4: A bank should incorporate liquidity costs, benefits and risks in the internal pricing, performance measurement and new product approval process for all significant business activities (both on- and off-balance sheet), thereby aligning the risk-taking incentives of individual business lines with the liquidity risk exposures their activities create for the bank as a whole.

MEASUREMENT AND MANAGEMENT OF LIQUIDITY RISK

Principle 5: A bank should have a sound process for identifying, measuring, monitoring and controlling liquidity risk. This process should include a robust framework for comprehensively projecting cash flows arising from assets, liabilities and off-balance sheet items over an appropriate set of time horizons.

Principle 6: A bank should actively monitor and control liquidity risk exposures and funding needs within and across legal entities, business lines and currencies, taking into account legal, regulatory and operational limitations to the transferability of liquidity.

Principle 7: A bank should establish a funding strategy that provides effective diversification in the sources and tenor of funding. It should maintain an ongoing presence in its chosen funding markets and strong relationships with funds providers to promote effective diversification of funding sources. A bank should regularly gauge its capacity to raise funds quickly from each source. It should identify the main factors that affect its ability to raise funds and monitor those factors closely to ensure that estimates of fund raising capacity remain valid.

Principle 8: A bank should actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions and thus contribute to the smooth functioning of payment and settlement systems.

Principle 9: A bank should actively manage its collateral positions, differentiating between encumbered and unencumbered assets. A bank should monitor the legal entity and physical location where collateral is held and how it may be mobilised in a timely manner.

Principle 10: A bank should conduct stress tests on a regular basis for a variety of short-term and protracted institution-specific and market-wide stress scenarios (individually and in combination) to identify sources of potential liquidity strain and to ensure that current exposures remain in accordance with a bank's established liquidity risk tolerance. A bank should use stress test outcomes to adjust its liquidity risk management strategies, policies, and positions and to develop effective contingency plans.

Principle 11: A bank should have a formal contingency funding plan (CFP) that clearly sets out the strategies for addressing liquidity shortfalls in emergency situations. A CFP should outline policies to manage a range of stress environments, establish clear lines of responsibility, include clear invocation and escalation procedures and be regularly tested and updated to ensure that it is operationally robust.

Principle 12: A bank should maintain a cushion of unencumbered, high quality liquid assets to be held as insurance against a range of liquidity stress scenarios, including those that involve the loss or impairment of unsecured and typically available secured funding sources. There should be no legal, regulatory or operational impediment to using these assets to obtain funding.

PUBLIC DISCLOSURE

Principle 13: A bank should publicly disclose information on a regular basis that enables market participants to make an informed judgment about the soundness of its liquidity risk management framework and liquidity position.

THE ROLE OF SUPERVISORS

Principle 14: Supervisors should regularly perform a comprehensive assessment of a bank's overall liquidity risk management framework and liquidity position to determine whether they deliver an adequate level of resilience to liquidity stress given the bank's role in the financial system.

Principle 15: Supervisors should supplement their regular assessments of a bank's liquidity risk management framework and liquidity position by monitoring a combination of internal reports, prudential reports and market information.

Principle 16: Supervisors should intervene to require effective and timely remedial action by a bank to address deficiencies in its liquidity risk management processes or liquidity position.

Principle 17: Supervisors should communicate with other supervisors and public authorities, such as central banks, both within and across national borders, to facilitate effective cooperation regarding the supervision and oversight of liquidity risk management. Communication should occur regularly during normal times, with the nature and frequency of the information sharing increasing as appropriate during times of stress.