Rabobank Nederland
Executive Board

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Introduction

Rabobank welcomes the opportunity to provide comments on the Basel Committee of Banking Supervision's consultative document 'International framework for liquidity risk measurement, standards and monitoring'. Although we agree with the comments put forward by the European Banking Federation, we would like to ask your attention for some specific elements in particular. The proposed framework aims to reduce systemic liquidity risk and further enhance consistency in international liquidity risk supervision by introducing new monitoring tools and measures for the ongoing assessment of banks' liquidity risk exposures.
The framework builds on previously published work by the Committee to strengthen the resilience of internationally active banks and to address deficiencies in banks' liquidity risk management and to respond to the G20 recommendation to introduce tools, metrics and benchmarks to promote stronger liquidity buffers at financial institutions.
While Rabobank agrees with the need for supervisors to strengthen the regulatory framework and for banks in general to improve their liquidity risk management we would like to focus in our comments on specific aspects of the two new regulatory standards in the context of the wider Dutch and European economies and peculiarities of the financial markets in the Netherlands, as the consequences of the proposed framework for the financial sector will be huge, also impacting a highly rated institution like Rabobank, which has withstand the credit crisis without any serious problems.

Executive Summary

While we agree with the need for supervisors to strengthen the regulatory framework and for banks in general to improve their liquidity risk management we would like to focus in our comments on certain specific aspects of the proposal, as the consequences of the proposed framework for the financial sector will be huge, also impacting a highly rated institution like Rabobank, which has withstand the credit crisis without any serious problems. We are not convinced that internationally active banks with significant cross-border exposures will not face a raft of additional and burdensome challenges to comply with the new regulatory standards. Although we are aware that internationally applicable liquidity standards cannot easily take into account the structure and peculiarities of certain national funding markets, we would like to point at the structure of the Dutch savings market, which puts Dutch banks at a disadvantage to international peers, because a large part of the household savings are absorbed by pension funds and insurance companies due to certain direct or indirect tax advantages.

With respect to the definition of 'stable' and 'less stable' funding we are of the opinion that it does not appropriately recognise the value of a well diversified funding base, the relationship with customers and is too much based on coverage by an effective deposit insurance scheme. This definition could even result to adverse results.

A too narrow definition of liquid assets will lead to a new concentration risk in the banks' balance sheets, and even this asset class can become illiquid as during a market wide crisis all institutions will be trying to liquidate the same asset class.

The Net Stable Funding Ratio (NSFR) includes a number of asymmetries, as retail lending funded with stable retail deposits will lead to a gap, and also a perfectly matched position of a one year corporate loan funded by a one year bond creates a substantial gap. Management intervention is also not taken into account, as retail and corporate lending will largely be continued as before. If a bank will not receive any wholesale funding for a period of one year, it is quite unrealistic to assume that management will not intervene.

An important risk mitigation factor for a bank's liquidity risk exposure that is complete ignored in the proposals is a superior credit rating. The proposal implies that irrespective of the current credit rating, the impact of a firm-specific stress scenario will be the same for everyone. This is in practice, of course, not true. It also does not include an incentive for banks to improve their credit rating and risk profile.

The liquidity value of unencumbered assets is also not taken into account. During the crisis, banks with an elevated level of securitized assets in combination with providing credit enhancements and liquidity facilities to funding vehicles suffered from acute funding problems and a lack of refinancing opportunities. Conversely, banks with a substantial amount of unencumbered high quality retail assets would generally have a greater potential to monetise part of their asset base, certainly within the one year horizon of the NSFR scenario. Rabobank proposes that this ability should be reflected in the RSF factor.

To conclude, we agree with the need to strengthen the regulatory framework and for banks in general to improve their liquidity risk management, but we would like to warn for applying a

too simplistic approach, by implying that one ratio, in particular the NSFR, could give a fair view of the liquidity risk position of all institutions, irrespective of credit ratings, business models, regional and country specific issues. We therefore propose that, next to a calibrated standardised approach, in particular for the NSFR, banks should be allowed to use a more advanced approach, based on internal models.

General observations

Harmonisation of parameters, level playing field issues and disclosure
The two new proposed standards, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) promoting the short-term and longer-term resilience of the liquidity profile in our view do have complementary objectives. However, we question the ultimate scope for using internationally harmonised specific parameters against the background of self-sufficiency requirements of national regulators and their desire to take jurisdiction-specific conditions and market practices into account when exercising national discretion over certain parameters. Although the Committee seeks to address those concerns with enhanced transparency and disclosure requirements regarding parameters set by national supervisors, we are not convinced that internationally active banks with significant cross-border exposures will not face a raft of additional and burdensome challenges to comply with the new regulatory standards.

Savings market in the Netherlands
We are aware that internationally applicable liquidity standards cannot easily take into account the structure and peculiarities of certain national funding markets. Although Rabobank has the largest market shares of savings deposits among the Dutch banks (40%), its access to retails savings deposits in order to fund residential mortgages is constrained by the structure of the Dutch savings market. In the Netherlands, close to three quarters of Dutch household savings are absorbed by pension funds and insurance companies, which have certain direct or indirect tax advantages. This puts Rabobank, and all Dutch banks for that matter, at a disadvantage compared to its peers. As a result of this structural imbalance, Dutch banks need a comparatively higher amount of longer term and more expensive wholesale funding to comply with NSFR requirements.

Definition of stable funding
In defining the two ratios the Committee mentions the respective components of Available Stable Funding and their associated ASF factors. One of the key objectives for prudent liquidity risk management in banking is to develop relationship driven, stable and diversified funding sources, both with retail and wholesale clients. In our view, the definition of 'stable' and 'less stable' funding and the respective ASF is too much based on the coverage by an effective deposit insurance scheme. The existence of a deposit insurance scheme can even lead to attracting more price sensitive and thus unstable retail deposits, and as such could lead to less

stable funding. In addition could the increased focus of all institutions on retail deposit result in a general destabilization of retail deposits market, as the total amount of available retail deposits is limited.
The definition of 'stable' and 'less stable' funding and the respective ASF also does not appropriately recognise the value of a well diversified funding base. Throughout the financial crisis, Rabobank benefited from access to a variety of funding sources, provided by non-financial and financial corporate depositors from different industry sectors and geographies. We strongly advocate that the ASF factors should give credit to banks for a diversified funding base. This could be realized by allowing banks to opt for an advanced approach where banks are allowed to use more appropriate factors in case the national regulator has satisfied itself that even in stress scenarios as defined by the Committee, relationship driven and diversified funding sources are a mitigating a bank's liquidity risk exposure.
Rabobank proposes that deposits from clients, with whom the bank has a long-standing relationship of at least three years should be more favourable recognised in the ASF factor and receive a 90% weighting for 'stable' and 75% for 'less stable' deposits.

Liquidity Coverage Ratio

Rabobank broadly agrees with the concept of a Liquidity Coverage Ratio as proposed by the Committee to ensure that banks have a sufficient stock of highly liquid assets to survive an imminent stress situation lasting for one month.
A key element of the discussion is the definition and required characteristics of highly liquid assets, the assumptions for defining an acute stress scenario and the haircuts applied for the various classes of eligible securities. In our view it is lamentable, that the haircuts do not seem to be based on comprehensive research, behavioural studies or other evidence, and, in the absence of any disclosure in the document, appear rather arbitrary. We would expect that through impact studies and ongoing gathering of data, the respective parameters will be reviewed and adjusted as and when necessary.
Rabobank is strongly advocating the mutual recognition of eligible highly liquid assets, which would enable a bank to pledge those assets with central banks in other jurisdictions in order to address acute liquidity shortfalls. If all institutions will be focusing on the same kind of liquid assets, being certain government securities, this will lead to a new concentration risk in the banks' balance sheets. In addition even this asset class can become illiquid as during a market wide crisis all institutions will be trying to liquidate the same asset class.

Net Stable Funding Ratio

The asymmetries
Although by looking at the applied factors one could think that the NSFR applies the same kind of assumptions to the asset side as to the liability side, a further analysis shows that this is certainly not the case. If for retail lending with a maturity of less than one year it assumed that

85% will be rolled, and at the same time 'stable' retail deposits are for 85% included as available stable funding, the percentages are the same, but the actual amounts involved are completely different as only a small part of the retail lending will be with a maturity of less than one year, and a large part of the stable retail deposits will be withdrawable at short notice. This creates a substantial gap. Transforming retail deposits into retail lending is by the way the classical transformation function of banks. Also a perfectly matched position of a one year corporate loan funded by a one year bond, creates a substantial gap, as the corporate loan requires 50% stable funding, whereas the one year issued bond has no value at all as available stable funding. Next to the asymmetries, the NSFR scenario does not seem to take into account any management intervention, as retail and corporate lending will largely be continued as before. If a bank will not receive any wholesale funding for a period of one year, it is quite unrealistic to assume that management will not intervene.

The impact of credit ratings

An important implicit risk mitigation factor for a bank's liquidity risk exposure that is complete ignored in the proposals is a superior credit rating. Rabobank holds the highest credit rating from Moody's and Standard & Poor's continuously since 1981 and throughout the crisis had ample access to short and long term wholesale funding from the money markets and capital markets. Even when considering the Committee's assumed three notch downgrade in a bank's public credit rating based on an idiosyncratic and market-wide shock, Rabobank advocates that banks, which pursue a proven low volatility and prudent business model with a strong focus on retail- and community-driven banking should receive an ASF mark-up to account for the higher stickiness of their retail and wholesale funding sources. The current proposal implies that irrespective of the current credit rating, the impact of a firm-specific stress scenario will be the same for everyone. This is in practice, of course, not true. It also does not include an incentive for banks to improve their credit rating and risk profile.

Also for the short term wholesale funding markets, a high credit rating has a beneficial impact for a bank's access to funding. As a consequence, even for a bank with an external public rating of at least AA, 20%-30% of the outstanding amount per wholesale funding source (including central bank and fiduciary deposits, and funds from asset managers and pension funds) should be recognised as available funding in the calculation of the NSFR.

Liquidity value of unencumbered assets

The document includes a strong focus on the liquidity value of encumbered and unencumbered assets with a favourable recognition and treatment of unencumbered assets in both the LCR and NSFR. During the financial crisis, banks with an elevated level of securitized assets in combination with providing credit enhancements and liquidity facilities to funding vehicles suffered from acute funding problems and a lack of refinancing opportunities. Conversely, banks with a substantial amount of unencumbered high quality retail assets would generally have a greater potential to monetise part of their asset base, certainly within the one year horizon of the NSFR scenario. Rabobank proposes that this ability should be reflected in the

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RSF factor. For residential mortgages, for instance, this could be achieved through a tiering of the RSF Factor for unencumbered assets based on the LTV ratio of the underlying mortgages.

To conclude

We would like to remark that there is much more to say about the proposed framework. For example we did not even touch upon items like the transformation function of banks, macro-economical issues and the huge negative impact this is expected to have on the real economy, but we expect that others will bring this to your attention.
Although we agree with the need to strengthen the regulatory framework and for banks in general to improve their liquidity risk management, we would like to warn for applying a too simplistic approach, by implying that one ratio, in particular the NSFR, could give a fair view of the liquidity risk position of all institutions, irrespective of credit ratings, business models, regional and country specific issues. We therefore propose that, next to a calibrated standardised approach, in particular for the NSFR, banks should be allowed to use a more advanced approach based on internal models. After all, a good understanding of the liquidity risk position of the bank by both the senior management of the bank and the regulator, in combination with a constructive dialogue between the regulator and the bank are of much more importance than simply complying with a set of very strict rules.

Best regards,
Rabobank Nederland

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Chief Financial Officer