The Clearing House℠

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Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Proposals to Strengthen Liquidity Risk Measurement, Standards and Monitoring

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("*The Clearing House*"), an association of major commercial banks[1], appreciates the opportunity to comment on the Basel Committee's December 2009 consultative document (the "*CD*"), *International framework for liquidity risk measurement, standards and monitoring* (the "*Proposals*").[2]

The observation in Paragraph 1 is indisputable – "**[t]**he crisis illustrated how quickly and severely liquidity risks can crystallize and certain sources of funding can evaporate . . .". Banks[3] and their regulators must deal with this phenomenon. We endorse the Committee's efforts to enhance the resilience of internationally active banks

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1 The member banks of The Clearing House are Bank of America, N.A., The Bank of New York Mellon, Capital One, N.A., Citibank, N.A., Deutsche Bank Trust Company Americas, HSBC Bank USA, National Association, JPMorgan Chase Bank, N.A., The Royal Bank of Scotland N.V., UBS AG, U.S. Bank N.A. and Wells Fargo Bank, National Association. The following members of our affiliate, The Clearing House Payments Company L.L.C., participated in the preparation of this letter and endorse its positions: Branch Banking and Trust Company, Comerica Bank, KeyBank, N.A., PNC Bank, N.A. and Union Bank, N.A.

2 The Clearing House is submitting a separate letter commenting on the Committee's capital proposals, *Strengthening the resilience of the banking sector* (the "*Capital Proposals*"). Additionally, a number of The Clearing House banks will submit their own comment letters on the Proposals and the Capital Proposals, including in many cases comments on aspects of the Proposals and Capital Proposals that particularly impact the operations of those banks.

Capitalized terms used herein and not otherwise defined are used with the meanings assigned to them in the CD. Paragraph references are to paragraphs in the CD.

3 We are using the term "*banks*" to mean both bank holding companies and depository institutions that are internationally active banking organizations.

to liquidity stress and, as part of those efforts, to develop clearer principles for the quantitative measurement of liquidity risk. As a conceptual matter, we support the application by banks of a short-term measure to address liquidity needs under an acute liquidity stress scenario, like the liquidity coverage ratio, or "*LCR*", outlined in the Proposals. We also believe that banks' analysis of their liquidity risk, and national regulators' supervisory oversight of that risk, should take into account structural mismatches between short-term funding and longer-term assets, which the Proposals attempt to address with the Net Stable Funding Ratio, or "*NSFR*."

We are deeply concerned, however, with the approach taken by the Committee in the Proposals and are committed to working with the Committee and our national regulators to develop sound and effective approaches to the measurement, analysis and supervision of liquidity risk that address what we believe are the weaknesses of the Proposals.

EXECUTIVE SUMMARY

A. Fundamental Concerns

Our principal concerns with the Proposals are in four areas.[4]

- Prescribed Ratios; Alternative Approaches. We continue to believe that a principles-based approach to liquidity risk management is the better approach. We are skeptical that the prescriptive approach of the Proposals can be adjusted to provide the best approach to the measurement, analysis and supervision of liquidity risk and urge the Committee to consider permitting national regulators much more flexibility in establishing funding parameters[5] based on actual experience in their jurisdictions and permitting banks that have developed internal liquidity models ("*ILMs*") for measurement and management of liquidity risk, and can demonstrate the efficacy of those models to the satisfaction of their national regulators, to use those models as an alternative to

[4] By letter dated July 31, 2008, The Clearing House commented on the Committee's initial release of its *Principles for Sound Liquidity Risk Management and Supervision*, ultimately issued in September 2008 (the "*2008 Principles*"). We noted in particular that the 2008 Principles avoided mandatory quantitative standards and urged the Committee not to require mandatory quantitative disclosures. Those two comments on the 2008 Principles are among our most basic concerns with the Proposals.

[5] In the letter, we use the term "*funding parameters*" to mean the numerators and denominators in the ratios (for example, the haircuts on components of the numerator in the LCR, the run-off factors for the denominator in the LCR, the ASF Factors applied in calculating the numerator in the NSFR, and the RSF Factors applied in calculating the denominator in the NSFR).

the LCR and NSFR. If the Committee proceeds with prescribed ratios like the LCR and NSFR, it is exceedingly important that banks, regulators and market participants (analysts, investors, creditors and counterparties) recognize that those ratios are but two of many tools for measuring liquidity risk. We urge the Committee and national regulators not to focus on the LCR and NSFR so narrowly and prescriptively that banks are deterred from developing more advanced ILMs tailored to the particular nature of their own businesses and the evolving nature of liquidity risk.

Both the LCR and the NSFR have serious flaws. The LCR can be fixed more easily than the NSFR, however, most importantly by expanding the scope of high-quality liquid assets for purposes of the numerator in the ratio and adjusting the funding parameters used to determine net cash outflow in the denominator to reflect actual experience. Our concerns with the NSFR are more fundamental. We agree that structural mismatches between short-term funding and longer-term assets should be addressed as part of liquidity management and supervision. However, given its severe assumptions, the NSFR goes too far in eliminating those structural mismatches. It would fundamentally change the role of banks in maturity transformation.

- Disclosure. We are concerned that the required disclosure by banks of their LCR and NSFR percentages may destabilize some banks. In our view the better approach would be one where, if the Committee proceeds with a prescriptive LCR and NSFR as contemplated by the Proposals, banks' percentages under those ratios would not be publicly disclosed but, instead, would be recognized and accepted for what they are – just two of many tools used by national regulators and banks to evaluate and manage liquidity risk. Although we urge the Committee not to require disclosure, we are very concerned that, inevitably, irrespective of whether disclosure is required by national regulators, banks' ratios under the LCR and NSFR will become public. That likelihood makes it even more important that the ratios be properly and realistically calibrated. We believe that many of the funding parameters and assumptions underlying the LCR and NSFR are excessively conservative and need to be re-calibrated so that calculations under the ratios produce a more realistic picture of banks' liquidity positions.

- Macroeconomic Impact. We urge the Committee to give greater attention to the macroeconomic impacts of the Proposals, together with other legislative and regulatory initiatives (including the Committee's own Capital Proposals) that are substantially

changing the landscape for bank regulation and the definition and conduct of the banking business.

- Process and Timing. We urge the Committee to adopt a less accelerated timeline for finalization of definitive Proposals, and their implementation, that permits the Committee to more fully explain the analysis underlying the Proposals, particularly the research undertaken and data used in developing funding parameters, and allows regulators and banks to comment once they understand that analysis and can evaluate the impact of the ongoing quantitative impact studies, or "*QIS*."

B. Recommendations on Specific Elements of Proposals

In order to assist the Committee in understanding our view that a principles-based approach to liquidity risk management will produce better results than the prescriptive approach of the Proposals, we have set forth in Part II.A under "Detailed Comments" our more specific concerns with the Proposals, summarized below.

1. Liquidity Coverage Ratio. As indicated above, as a conceptual matter, we support the application by banks of a short-term measure to address liquidity needs under an acute liquidity stress scenario, like the LCR. However, we are deeply concerned with certain aspects of the LCR. Our principal concerns with the LCR, discussed in Part II.A of our Detailed Comments, are with the excessively conservative assumptions in the stress scenario for the LCR, unsupported in our view by the experience of U.S. banks during the financial crisis; the definition of "high-quality liquid assets" for purposes of the numerator in the LCR, which we believe should be substantially expanded; run-off factors for both retail and wholesale deposits that assume much higher run-off in a number of areas than was experienced by our member banks during the financial crisis; the assumption that there is no rollover of repos or other short-term funding transactions, except for those supported or secured by high-quality liquid assets, which we feel is far too extreme; the asymmetry in the provisions addressing draw-downs of committed credit and liquidity facilities in the treatment of banks as borrowers and lenders; the failure to recognize liquidity provided by the Federal Home Loan Banks ("*FHLBs*") in the United States; and certain other aspects of the funding paramaters.

2. Net Stable Funding Ratio. Our principal concerns with the NSFR, discussed in Part II.B of our Detailed Comments, begin with its basic premise. Although we support the general goal of addressing excessive reliance on wholesale funding through regulatory oversight, we are skeptical that the best way to do that is with a highly prescriptive ratio applied in the same manner across institutions and jurisdictions over a single time horizon. The NSFR would directly affect the role of banks in maturity transformation—that is, intermediating the imbalances between short-term and long-term needs of borrowers and the availability of credit. We are concerned that the macroeconomic consequences of narrowing the role of banks in maturity transformation

are not understood.

In addition to that fundamental and conceptual concern with the NSFR, our other concerns include the scenario assumed for the NSFR, which is extremely conservative; the inclusion in the denominator of the NSFR of match-funded non-renewable loans with a maturity of one year or less, which do not present a structural funding mismatch and we believe should be excluded; the failure to take into account the likelihood of central bank support in an extended period of crisis; certain of the ASF Factors and RSF Factors which seem to us to be inconsistent with historical experience, including during the recent financial crisis, and unduly conservative; the treatment of intangible assets (which are assigned a 100% RSF Factor and we believe should be assigned a 0% RSF Factor); the failure to give any credit for outstanding borrowings from FHLBs or a bank's ability to drawdown under a facility with an FHLB; the assignment of a 0% ASF Factor to term securitizations and ABCP and a 100% RSF Factor to many of the assets underlying those term securitizations and ABCP programs, notwithstanding that they have shown themselves over a longer-term time horizon to be durable sources of funding; the asymmetric treatment of repos and reverse repos; and the asymmetry in the interplay between the LCR and the NSFR.

3. <u>Monitoring Tools</u>. We address, in Part II.C. of our Detailed Comments, concerns with several additional aspects of the Proposals, including the frequency of reporting, the definition of "significant counterparty" in Paragraphs 106 and 107, and operational challenges raised by the Proposals.

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There is an inherent tension between greater liquidity and the capacity of financial institutions to serve the needs of their customers and the economy. The appropriate balance between the two must be assessed over the long term, and the recent financial crisis demonstrates that the balance requires adjustment. Nonetheless, the objective should be to achieve the best balance for long-term economic prosperity rather than to reject the concept of balance in favor of attempting to assure a risk-free financial system.

DETAILED COMMENTS

This letter discusses more fully in Part I our fundamental concerns referenced in the Executive Summary, above, and comments in Part II on specific aspects of the Proposals that are more granular and less broadly conceptual but illustrate our concern with the prescriptive approach of the Proposals. We hope that our comments will assist the Committee in developing balanced standards for revised Proposals that will assist financial institutions and their prudential regulators in managing liquidity risk.

I. Fundamental Concerns

A. Prescribed Ratios; Alternative Approaches

We endorse the Committee's efforts to enhance the resilience of internationally active banks to liquidity stress and, as part of those efforts, to develop clearer principles for the quantitative measure of liquidity risk. As a conceptual matter, we support the application by banks of a short-term measure to address liquidity needs under an acute liquidity stress scenario, like the LCR, and we believe that banks' analysis of their liquidity risk, and national regulators' supervisory oversight of that risk, should take into account structural mismatches between short-term funding and longer-term assets of the type the Proposals attempt to address with the NSFR (discussed further in Part I.B, below).

However, we are concerned that the level of prescriptiveness in the Proposals, with its very precise funding parameters for calculation of those ratios, is unsound. That approach is the equivalent of Basel I[6] for capital. It fails to recognize differences among banks. In a number of cases it specifies funding parameters that are at odds with the experience of The Clearing House members, and we believe the banking industry more generally, including during the financial crisis. Among the most significant deviations between the Proposals and actual experience, in the case of the LCR, are the run-off factors for customer deposits – both retail and wholesale – and the assumed level of drawings on credit and liquidity lines, both of which factor into the denominator in that ratio. Moreover, some of the assumptions (with respect to both the components of the numerators and denominators in the ratios and the calibration of the funding parameters) are so unduly conservative that, collectively, they could push banks beyond sound liquidity management practices and into a zone where the resultant need to hold a mandated amount of narrowly defined high-quality liquid assets causes banks to cut lending and financial intermediation services. In addition, banks will be obligated to raise significant additional capital that they likely will have difficulty raising if the Proposals, together with the Capital Proposals and other regulatory initiatives, depress returns on equity of the international banking sector generally.

All The Clearing House banks have, and are continuing to refine based on the experience and learning of the last several years, internal models that they use to measure and evaluate their liquidity. We expect that other (and likely most if not all) internationally active banks are engaged in similar endeavors, and the Committee and national regulators of course are well aware of those endeavors. The quantitative measurement and financial modeling of liquidity risk is by its nature more institution-specific than the regulation of bank capital. Liquidity risk management depends on a

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6 We are using the term "*Basel I*" to mean the Basel Committee's 1988 risk-based capital framework titled *International Convergence of Capital Measurement and Capital Standards*. We are using the term "*Basel II*" to mean the Basel Committee's June 2006 comprehensive new accord titled *International Convergence of Capital Measurement and Capital Standards – A Revised Framework*.

greater number of firm-specific variables than capital management, including business model, mix of business, market participation, and market status and access. As a consequence, there has been – and we believe, both as a matter of supervisory policy and sound management for individual banks, should be – less convergence around standardized approaches to measuring liquidity risk than approaches to other aspects of bank regulation, including capital, particularly with respect to the stability of funding over a longer-term horizon. Where the Proposals recognize the need to give national regulators some discretion to accommodate jurisdiction-specific considerations and differences[7], they do not recognize or accommodate differences among banks within a jurisdiction or more generally. That is a significant departure from the historical approach to monitoring and regulating liquidity risk. National regulators historically have recognized, even in recent pronouncements, the reality that liquidity risk processes and systems are not reducible to prescriptive formulas.[8]

We urge the Committee to reconsider whether the level of international harmonization sought by and embodied in the Proposals – particularly in the standardized funding parameters – is the best approach. We believe that it is not and that a less prescriptive approach that is guided by principles enunciated by national regulators but that benefits from the knowledge and understanding that (i) national regulators have of banks and the banking business in their jurisdictions and (ii) individual banks have of their own businesses – a Pillar 2-type approach – will produce a better result. Under a less prescriptive and more principles-based approach, quantitative measures – whether the LCR and NSFR, if the Committee decides to proceed with those ratios, or other revised ratios after taking into account comments received and the results of the QIS – would not specify funding parameters. Instead banking regulations would leave the funding parameters used by each bank to its discretion, in discussion with its national regulator as a matter of supervisory oversight. This approach would also give banks some flexibility, in discussion with their national regulators, to determine the components of the numerators and denominators in the ratios.

The need for an alternative approach is particularly important in the case of the NSFR. A prescriptive approach is inherently more likely to include inappropriate funding parameters and produce undesired and problematic results over a longer-term time horizon.

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7 See Paragraphs 10, 18, 39 and 91, for example.

8 The U.S. Department of the Treasury and the U.S. Federal bank regulatory agencies, in their revised *Interagency Policy Statement on Funding and Liquidity Risk Management* issued last month, 75 Fed. Reg. 13656, 13661 (March 22, 2010), commented on this several times, including in Paragraph 5 of the Policy Statement as follows:

> "An institution's obligations, and the funding sources used to meet them, depend significantly on its business, mix, balance-sheet structure, and the cashflow profiles of its on- and off-balance sheet obligations."

We urge the Committee to permit banks that have developed ILMs for measurement and management of liquidity risk, and can demonstrate the efficacy of those models to the satisfaction of their national regulators, to use those models as alternatives to the LCR and NSFR. This would effectively be an "*enhanced Pillar 2*" approach, similar to the foundation and advanced internal ratings-based, or "*IRB*," approaches to capital in Basel II. Under this approach, the Committee would adopt an LCR and NSFR as the foundation approach to liquidity measurement (perhaps including some guidance as to funding parameters), taking into account comments received on the Proposals and learning obtained through the QIS, but then also permit banks to propose and, if approved, instead use as an alternative ILMs tailored by each bank to its own business and experience, as the advanced approach to liquidity measurement. The liquidity rules of national regulators would specify minimum requirements for initial and ongoing use of ILMs proposed by individual banks taking into account their own circumstances and the unique aspects of their businesses, similar to the advanced IRB approach to capital in Basel II. The minimum requirements for use of ILMs likely would include the objectives that must be achieved by the internally developed ratios and the scope of components that must be covered by the numerators and the denominators in those ratios, but would permit flexibility to individual banks as to the components of the numerators and denominators and would not specify precise funding coefficients. The determination as to whether a particular bank could apply an internal approach would ultimately be made by its regulator after evaluating the bank's proposed internal approach against these specified criteria.

If the Committee determines not to permit use of ILMs as an alternative to prescribed ratios at the outset, we urge the Committee nevertheless affirmatively to encourage banks, with language to that effect in the Proposals, to continue their ongoing endeavors to develop ILMs tailored to their individual businesses and to leave open the possibility that, at a future date, as the validity of liquidity risk management techniques become more demonstrable through testing, ILMs may in fact replace and not merely supplement prescribed ratios as liquidity measurement tools for some banks.

The more prescriptive the ratios ultimately adopted, the more important it becomes that relevant constituencies – market participants (analysts, investors, creditors and counterparties), banks and even regulators – recognize those ratios for what they are, only two of many tools for measuring and managing liquidity risk, all of which have an inherent degree of imprecision and none of which is equally appropriate for all financial institutions. We are very concerned that market participants, banks and regulators will place excessive importance on these ratios. The consequence could be to distort fundamental decisions by banks with respect to the businesses they choose to conduct, in particular with respect to financing broad elements of the economy. This may not be of significant concern in countries where lending is predominantly state directed or to large companies, but it is of far greater concern in countries where lending is more focused on smaller businesses and consumers who require more stable (i.e., longer-term) financing. The mere fact that one bank has a higher LCR or NSFR than another bank, when viewed in the context of the totality of both banks' businesses, does not necessarily support a conclusion that the second bank has more liquidity risk than the first bank. We are very

concerned that the Proposals will effectively force banks to manage their businesses to achieving LCR and NSFR percentages that place them comfortably within a zone mandated by the marketplace for their peer group, even if doing so does not produce the best decision-making, either with respect to liquidity risk management or the conduct of the bank's business more generally.

B. Disclosure

We urge the Committee not to require banks to disclose their percentages under liquidity ratios (whether the LCR and NSFR or other metrics that may be implemented). As discussed below, we are concerned with the consequences of public disclosure by banks of their percentages under the LCR and NSFR. In our view, could it be achieved, the better approach would be to not have public disclosure by banks of their LCR and NSFR ratios but, instead, use the LCR and NSFR only as supervisory tools – a component in the assessment by banks, national regulators and supervisory colleges to determine the adequacy of a bank's liquidity position and processes. Inevitably, the more standardized the funding parameters and other substance of the ratios, the less reliable are the ratios as tools to measure liquidity risk in a truly meaningful manner across different mixes of businesses, geography and market participation.

Considerations bearing upon the disclosure of liquidity ratios are very different from those bearing upon the disclosure of capital ratios. Calculations of capital ratios are largely numerical, deriving from financial statements. Liquidity measurement is substantially more complex. Liquidity measures do not derive from financial statements and depend for a particular bank upon its interactions with the market. As a consequence, liquidity ratios are useful as a tool for supervisory oversight, to be evaluated by regulators with discretion, but much less useful as a disclosure metric to be considered by depositors and market participants.

The risks associated with disclosure of LCR and NSFR ratios are both apparent and significant. Public disclosure may expose banks to market penalties for marginal differences in their ratios as compared to peers, even where the differences do not reflect meaningful differences in the banks' respective liquidity strength. In some cases disclosure may exacerbate any existing liquidity problems, potentially setting off a "death spiral" in which disclosure of the LCR or NSFR ratios for a bank with ratios below those of its peer banks makes obtaining funding more costly, if not impossible, which in turn amplifies underlying liquidity issues.

With that said, however, we are concerned that banks' LCR and NSFR percentages will end up being publicly disclosed even if disclosure is not mandated.[9] The

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9 We in fact considered whether the best approach would be to treat banks' percentages under the LCR and NSFR as confidential supervisory information that, like examination reports in the United States, banks would in fact be *prohibited* from disclosing. However, for the reasons addressed in this paragraph, we ultimately concluded that that approach simply is not practicable.

more prescriptive and standardized the LCR and NSFR, the greater the likelihood of public disclosure. Analysts are likely to model the LCR and NSFR ratios of banks they follow, necessarily making a variety of assumptions because much of the information necessary to calculate the ratios is not publicly available. Inevitably the analysts' modeling will be wrong, sometimes by significant amounts. Banks will feel compelled to make public more accurate disclosure in order to rebut mis-impressions arising from incomplete information available to analysts. Moreover, some banks may in fact choose to disclose their LCR and NSFR ratios as a competitive matter – because they believe their ratios demonstrate a strong liquidity position compared to their peers.

The likelihood of ultimate disclosure makes it even more critically important that the LCR and NSFR, as ultimately calibrated, be as accurate and realistic as possible. As indicated in the Executive Summary of this letter, we believe that the calibration in the Proposals is not realistic and includes funding parameters that are at odds with the experience of The Clearing House members generally and during the financial crisis. Our more specific comments in this regard are set forth in Part II. They include:

- the narrow definition of liquid securities to be included in the liquidity buffer under the LCR (Part II.A.2);
- the degree of run-off of wholesale deposits (Part II.A.4);
- the degree of access to wholesale funding markets (Part II.A.5);
- the scope of securities for which the repo markets remained open (Part II.A.5);
- the lack of recognition of the availability of secured funding through the FHLBs in the LCR (Part II.A.8) and of the stability of secured funding through the FHLBs in the NSFR (Part II.B.7); and
- the asymmetric treatment of repos and reverse repos in the NSFR (Part II.B.9).

C. Macroeconomic Impact

The potential macroeconomic effects of the Proposals, particularly when considered with other aspects of financial regulation reform, raise significant concern. The ongoing reform of bank regulation arising out of the financial crisis is exceedingly complex and has many components. Some, including the specific regulation of capital and liquidity, are within the recognized purview of bank regulators and can and should be addressed as a matter of regulation and supervisory oversight. Others – for example, resolution of systemically important institutions and broader frameworks for regulatory oversight – are the subject of legislation (or proposed legislation) in many jurisdictions, including the United States. Still others – for example, compensation practices,

limitations on powers and activities and the manner of funding resolutions of systemically important institutions – are being addressed both by bank regulatory agencies and legislators. Finally, certain other areas – accounting principles, for example – may be left to standards-setting organizations. All these components, however, irrespective of the relevant responsible authority, have a cumulative impact on banks and their role in the economy, and they cannot be considered in isolation.

The Proposals and the Capital Proposals, even considered without regard to other possible components of financial reform, must be considered and calibrated together, not in isolation. The Proposals are so conservatively formulated that they seem geared toward addressing capital concerns with robust liquidity. One example of that approach is the requirement in Paragraph 28 that, in order to be a high-quality liquid asset, the asset must "be easily and immediately converted into cash at little or no loss of value." Why? Loss of value customarily would be analyzed in the context of its impact on capital, not liquidity. The financial crisis demonstrated that the market's lack of confidence in the level of a bank's capital (and the ability of that capital to absorb losses) can trigger a liquidity crisis for the bank. Insufficient liquidity itself was not the triggering event.

The Clearing House members believe it is essential that the Committee and national regulators, in refining the Proposals, evaluate their macroeconomic consequences, taking into account not merely the Proposals but also the broader scope of regulatory reform (including the Capital Proposals and the Committee's July 2009 document titled *Revisions to the Basel II Market Risk Framework*) and the role of liquidity as one of many components of a sound financial system. Reform of liquidity regulation cannot be evaluated in isolation and, of course, will not be implemented in isolation.

We are very concerned, however, that the components of regulatory reform are being developed without the comprehensive evaluation of the consequences of all of those components, taken together, that is manifestly called for. Requiring financial institutions to maintain too great a stock of high-quality liquid assets (or defining too narrowly what qualifies as a high-quality liquid asset) poses risks that are equally as threatening to national economies as too low a stock of high-quality liquid assets (or too broad a definition), including reduced availability of credit, higher costs paid by consumers for loans and other banking services, potential disintermediation of activities historically conducted within banks to unregulated entities in the shadow banking system, reduced returns on equity for investors in financial institutions, related challenges for those institutions in raising additional capital, incentives for financial institutions to engage in activities or enter into transactions intended to maintain acceptable returns on equity of a type (and posing risks) not now contemplated, and more generally acting as an impediment to economic growth.

A significant increase in holdings by banks of a narrowly defined category of liquid assets inevitably will create market dislocations – as to both the availability and pricing of different types of assets – as banks shift investments from consumer-,

mortgage-, and business-related loans to cash, central bank reserves and government securities. This shift will be most pronounced for those borrowers who require stable funding sources, in the form of longer-term funding. As a key example, the goal of certain countries to promote home ownership will be directly frustrated by liquidity ratios that discourage mortgage lending. The market dislocations will be significant both for the defined liquid assets and the assets not within the definition (and which encompass virtually all customary bank lending products). The effects become magnified when considered with other initiatives that may incentivize banks to reduce their balance sheets (including, for example, the Capital Proposals and the initiatives in the number of jurisdictions to impose a levy or tax on banks to offset the cost of current interventions and/or to fund the cost of any future interventions).

We do not purport to have a good grasp of the consequences on banks or economies of the combined impact of the Proposals, the Capital Proposals and other financial reforms. We doubt anyone has a good grasp at this point. However, we note in particular two consequences of the Proposals and Capital Proposals, taken together, that particularly concern us. First is a variety of disincentives for banks to fund banks. These include, for example, (i) in the LCR the exclusion of any bank instruments from high-quality liquid assets and the assumed 100% run-off of wholesale funding provided by banks, (ii) in the NSFR, the assignment of a 0% ASF factor to funding provided by banks and a 100% RSF factor to loans to banks, and (iii) in the Capital Proposals, the required deduction from common equity of holdings in common stock of financial companies outside the scope of consolidation (including in connection with underwriting and market-making activities).

Second, the Proposals and the Capital Proposals, taken together, include disincentives to mortgage financing that could have a very adverse – and potentially devastating – effect on the U.S. housing market. The aspects of the Proposals and Capital Proposals most central to that concern are (i) in the Proposals, (x) the exclusion of mortgages and mortgage-backed securities (either directly or indirectly as collateral for borrowings from Federal Home Loan Banks) from the definition of high-quality liquid assets in the LCR and (y) the assignment, in the NSFR, of a 0% ASF Factor to Federal Home Loan Bank borrowings collateralized with mortgages and a 100% RSF Factor to mortgages and mortgage-backed securities held on the balance sheet; and (ii) in the Capital Proposals, the requirement that mortgage servicing rights be deducted from common equity.

D. Process and Timing

The proposals are detailed and quantitative. At the same time, they present many funding variables and other concepts with little elaboration of the research, data and modeling used to derive them. This does not allow us or other constituencies to comment with the thoughtfulness that we could if we were able to consider the Committee's research in deriving the funding variables. Accordingly, we believe that the Committee should make public its research so that banks can take it into account in evaluating the Proposals.

A number of The Clearing House members are participating in the QIS process. The QIS responses are due on April 30, 2010, shortly after the April 16, 2010 date on which comment letters on the Proposals are due. The amount of data to be gathered by banks participating in the QIS process is substantial, and the granularity of that data differs from what most members collect on a regular basis today. Those banks that are participating have indicated that their understanding of the Proposals and consequences of their implementation is substantially enhanced by participation in the QIS process. Because those banks are preparing comment letters prior to finalization of their QIS responses, they have indicated (i) a need to more fully absorb the understandings they have gathered through the QIS process in commenting on the Proposals (both through The Clearing House and in preparing their own comment letters), and (ii) concern that, because the comment letters will be submitted before completion of the QIS, they will not be able to reflect adequately in comment letters the learning they are gaining through the QIS process. More generally, we believe that the banking industry as a whole must have access to the data provided through the QIS, in an aggregated format, in order to comment meaningfully on the Proposals.

Accordingly, The Clearing House believes it is *essential* that the Committee publish revised Proposals for additional comment, before issuing a final set of standards. In order to make the additional comment process useful, we urge the Committee to establish a 90-day comment period on revised Proposals. The revised Proposals, of course, need to take into account the results of the QIS. Equally important, banks need to be able to evaluate the revised Proposals taking into account the results of the QIS as well as a better understanding of the Committee's analysis in developing the initial Proposals and the funding factors.

II. Recommendations on Specific Elements of Proposals

We continue to believe that a principles-based approach to liquidity risk management, guided by principles enunciated by national regulators but that benefits from the knowledge and understanding that (i) national regulators have of banks and the banking business in their jurisdictions and (ii) individual banks have of their own businesses – a Pillar 2-type approach, will produce better result than the prescriptive approach of the Proposals. In order to assist the Committee in understanding our reasons for that view, we have set forth in this Part II more detailed observations regarding

(i) certain aspects of the LCR and the NSFR, (ii) the new monitoring tools and (iii) the operational challenges associated with implementation of the Proposals.

A. Liquidity Coverage Ratio

1. The Scenario – Paragraphs 22-24. Paragraph 24 describes the stress scenario for the LCR as "a minimum supervisory requirement." Yet the scenario specified in Paragraph 22 is extremely conservative. It assumes, on an ongoing basis for every bank, that every adverse event observed as to a firm during the recent financial crisis applies to, and must continuously be addressed by, every firm. Even as a tool for supervisory oversight, let alone disclosure, we believe that some of its standards are excessively conservative and unsupported by the experience of U.S. banks during the financial crisis, in particular:

- the assumed levels of loss of unsecured wholesale funding, including the 100% assumed loss of unsecured wholesale funding provided by financial institutions (clause (c));

- the unavailability of the short-term repo market on, as a practical matter, all but government securities (clause (d)); and

- the assumed levels of draws on committed unused credit and liquidity facilities (clause (f)), implemented in paragraph 66, combined with an asymmetric assumption in paragraph 76 that banks will not be able to draw on their own committed credit facilities. This asymmetry demonstrates the extraordinary conservatism of the assumptions.

There is, of course, an inevitable trade-off between defining the severity of the scenario and tolerating the more severe macroeconomic consequences that are likely to result from assuming a more severe scenario (as acknowledged by the Committee in Paragraph 29). We urge the Committee, however, to consider whether the scenario specified in Paragraph 22 is unduly severe, particularly with respect to the components referenced above. We submit that it is appropriate to base certain regulatory requirements on a reasonable worst case, but that it is counterproductive to use, as the Proposals appear to, the worst case conceivable.

2. High-Quality Liquid Assets – Paragraphs 28, 29 and 34 through 37. We believe that the Proposals have defined too narrowly what constitutes a "high-quality liquid asset." The Proposals have a strong bias in favor of sovereign debt, mandating a material increase in banks' exposure to sovereign credit risk for incremental high-quality liquid assets at a time when sovereign credit quality is deteriorating. Shifting bank investments from the traditional array of assets toward a substantially increased focus on sovereign paper may assist some stressed sovereigns in raising debt, but it will affect the ability of corporate issuers to fund themselves.

Moreover, high-quality liquid assets is defined in the numerator of the ratio in a way that in many respects has little to do with liquidity. For example, as noted in Part I.C, Paragraph 28's requirement that an asset must be convertible into cash at little or no loss of value is a concept more relevant to capital than liquidity. We question whether that is the correct approach. The test for assets included in the numerator of the LCR should, insofar as liquidity is concerned, be focused on the ease with which they can be converted into cash (most importantly, the liquidity of the markets in which they trade). The Proposals themselves, by applying haircuts to the carrying amount of certain assets for the purpose of the numerator in the LCR, recognize the inconsistency between a "selling at no or little loss" test and a proper measure of liquidity. Presumably the haircuts are designed to reflect conservatively estimated losses.

Even if the "fundamental" and "market-related" characteristics of high-quality liquid assets described in Paragraph 29 were the relevant test, we believe those characteristics are found in a wider range of assets than those listed in Paragraph 34.

- *Obligations of Government-Sponsored Enterprises.* Paragraph 34 specifically excludes securities "issued by banks or other financial services entities," even where those securities are guaranteed by sovereigns (Paragraph 34(c)(iii)). We recommend including the obligations of government-sponsored enterprises ("*GSEs*") where there are deep and liquid markets for the obligations, subject to appropriate haircuts to be determined by national regulators. In the U.S., this would permit inclusion in high-quality liquid assets of debt of GSEs such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

- *Corporate Bonds.* We support the inclusion of highly rated, liquid corporate bonds in the stock of high-quality liquid assets. Such bonds, especially when meeting the extensive criteria set forth in the Proposals (Paragraph 36), have the quality and liquidity to justify their inclusion in the numerator of the LCR.

  We note that the criteria for qualifying corporate bonds, while obviously intended to correlate with safety and liquidity in times of financial crisis, include very specific quantitative tests for characteristics such as credit risk and historical bid-ask-yield spread. Furthermore, the proposed 20% and 40% figures for corporate bond haircuts are presented in the Proposals without elaboration or derivation and are, we believe, excessive. We believe that the Committee should disclose the models it has employed and the reasoning it has used to design these criteria and the associated haircuts, which are difficult to evaluate in a vacuum. The collective knowledge and experience of the constituencies commenting on the Proposals could be used to refine the treatment

of corporate bonds and potentially suggest other ways of tailoring their weighting more closely to the risk profiles of individual institutions.

- *Municipal Obligations*. We believe that obligations of municipalities (including state and local governments and other public-sector entities) should be given significant liquidity value in a 30-day time horizon. In the United States, municipal obligations generally maintained their value with a high degree of liquidity throughout the crisis.

- *Securities Issued by Banks or Other Financial Services Entities*. Clause (c)(iii) of Paragraph 34 excludes all securities issued by banks or other financial services entities. We believe that the exclusion is far too conservative. During the financial crisis, highly rated senior debt securities of many banks remained liquid and traded at prices that were at or near par.

- *Trading Portfolio Securities*. We believe that all securities carried in a trading portfolio should be includible in liquid assets for purposes of the numerator in the LCR. Under U.S. GAAP, securities in the trading portfolio have already been marked-to-market. Accordingly, liquidation of those securities should involve little or no additional loss.

3. <u>Retail Deposit Run-Off – Paragraph 41</u>. Paragraph 41 provides that certain "stable" retail deposits – which generally include funds deposited by natural persons and exclude other deposits – will receive at least a 7.5% run-off factor for purposes of calculating the LCR, and that other "less stable" retail deposits will be assigned a minimum run-off factor of 15%. Although this binary approach has the benefit of simplicity, it is by necessity arbitrary. As a general matter, we believe that such prescriptive minimum run-off factors are too conservative and do not reflect the experience of U.S. banks during the financial crisis. We anticipate our member banks, in their individual comment letters, will address their own experience with run-off factors as applied to specific types of deposits. One of general applicability, however, is deposits to the extent insured by the Federal Deposit Insurance Corporation ("*FDIC*"). Our experience uniformly was that deposits up to the insured amounts were exceedingly "sticky," not warranting more than a nominal run-off factor.

The minimum run-off factors fail to take into consideration differences among banks or any relevant jurisdictional and activity-specific factors that may render these assumptions unrealistic. At the most basic level, banks clearly had very different experiences during the financial crisis, from runs on some banks to flight-to-quality inflows at other banks. The run-off experience of a bank is, of course, affected by its credit quality. But it is also affected by a variety of other factors that are difficult to measure in a uniform way, including differences across jurisdictions in business customs,

customer behavior and legislation, and the financial reliability of government insurance schemes.

Data gathered during the recent financial crisis should enhance banks' and regulators' ability to forecast run-off factors. That data is from one of the most stressed times in modern financial history. We urge the Committee to disclose the data it used in developing the run-off factors in the Proposals and to make use of data covering the period of the financial crisis in refinancing run-off factors for the LCR.

We urge the Committee to permit national regulators to establish the run-off factors for deposits and other liabilities of banks within their jurisdictions based on empirical data relevant to the jurisdiction. We are very skeptical that uniform international standards will reflect accurately actual experience.

Many banks have substantial databases that can be used to establish reliable run-off factors for many types of liabilities, including retail and wholesale deposits, that differ from the experience of other banks in the same jurisdiction. Accordingly, we also urge the Committee to give national regulators discretion to permit banks to use run-off factors that may be different from (and perhaps less) than those otherwise established as the "default" measures for the jurisdiction where the relevant bank has demonstrated to the satisfaction of its regulator, based on empirical evidence, that its proposed run-off factors are accurate.

4. <u>Retail Deposit Bias – Paragraphs 41-55</u>. The run-off factors assigned to funding sources other than retail deposits and certain wholesale deposits from small-business customers (Paragraphs 41 and 48) for purposes of calculating the LCR are very (and we believe unduly) punitive. Like other aspects of the Proposals, the prescribed run-off factors for non-retail deposits fail to account for any relevant jurisdictional, institutional and activity-specific features that may render the prescribed run-off factors for such deposits unrealistic and needlessly conservative, including, for instance, national deposit insurance schemes. In addition, this bias against non-retail deposits could severely impact the business models of banks with deposits primarily comprising non-retail deposits, the associated costs of which may result in such banks curtailing or eliminating various lending and financial intermediation services.

We urge the Committee and national regulators, in considering run-off factors for wholesale deposits, to consider the degree of operational business relationships a depositor may have with a financial institution. The Proposals require up to 100% run-off factors for wholesale clients, without regard to relationships resulting from, for example, trust, custody, or securities servicing business, that affect run-off experience. These relationships generate frictional cash that is a function of the business relationship. Usually depositors cannot shift contractual arrangements quickly to another provider. Shifts to alternative providers can involve significant technical and operational resources, and cannot occur quickly. The depth of the relationships does not vary if the depositor is a financial institution or nonfinancial corporation. Such deposit balances may be relatively stable even during periods of financial distress for this reason. We

propose run-off rates for deposits with such relationships to be based on historical data observed during periods of market stress, or benefit in a similar fashion, as nonfinancial corporations with an operational relationship.

5. Secured Funding Run-Offs, Including Repos – Paragraphs 57-59. The assumption in Paragraphs 57-59 that there is no rollover of repos or other short-term funding transactions, except for those supported or secured by high-quality liquid assets, is far too extreme in our view. The repo markets remained very active during the financial crisis for a far wider scope of securities than the assets assigned a 0% outflow factor in the chart in Paragraph 59. We are aware of no empirical evidence to support a 100% loss of funding across every asset class that is not in the 0% category. The funding parameters reflected in Paragraphs 57-59 would only apply to a firm in, and perceived to be in, its final hours. In our view that standard is far too conservative for an industry-wide compliance metric even in the context of a severe financial crisis.

6. Haircuts on Collateral Securing Derivative Transactions – Paragraph 63. The requirement in Paragraph 63 that collateral posted to secure derivative transactions be increased by 20% of the value of all posted collateral seems arbitrary to us and not supported by recent experience. Depending upon the nature of the posted collateral and the terms of the derivative contract, substantial haircuts are already being applied to most types of collateral other than government securities. We urge the Committee to re-examine, against available data sources, the appropriateness of the 20% funding parameter applied to collateral for these transactions.

7. Draws on Committed Credit and Liquidity Facilities and Lines of Credit – Paragraphs 66 and 76. The assumptions regarding draw downs of committed credit and liquidity facilities are asymmetrical and exaggerated. Under Paragraph 66, a bank would have to assume that 100% of committed liquid facilities to non-financial corporate customers and 100% of committed credit and liquidity facilities to other legal entities, including financial institutions, are fully drawn down; however, pursuant to Paragraph 76, it would also have to assume that no credit, liquidity facilities or other contingent funding facilities may be drawn by it, including those provided by other financial institutions.

First, our member banks' experience during the financial crisis was that the proportion of committed amounts drawn on credit and liquidity facilities to corporate customers remained mostly unchanged from pre-crisis levels. Corporate customers simply do not make uneconomic decisions and borrow amounts (and incur a resultant negative carry) that they do not need.

Second, although we believe that lines of credit where the bank is the borrower should be discounted to a certain extent given that some lending banks may be unable to honor credit lines or decide that the benefits of reneging on their commitments outweigh the costs of honoring them, we find the assumption that the expected availability of such lines of credit is $0 excessively conservative. Even under conditions of acute financial distress, such an outcome is highly unlikely. Instead, we believe that

this value is best established through a supervisory process in which a supervisor, taking into account relevant jurisdictional and institution-specific factors, determines a value that attempts to reflect the likelihood that lines of credit will, or will not be, honored. In our view these factors should include, among others, an assessment of the contractual clauses in the lines of credit, the jurisdiction-specific consequences of failing to honor such lines of credit and historical data regarding the availability of such commitments in periods of financial distress.

8. Federal Home Loan Bank Borrowings. For many U.S. banks, lines of credit with the regional FHLBs are an important and reliable source of liquidity. The FHLBs are government-sponsored entities whose own borrowings are conducted on a consolidated basis through a combined funding office. Borrowings from the FHLBs are secured, and each FHLB specifies its own collateral requirements. Eligible collateral customarily includes a variety of assets, including mortgages and mortgage-related securities, that are much broader in scope than the high-quality liquid assets as defined for purposes of the LCR. The LCR as described in the Proposals does not give effect to the availability of FHLB borrowings. We believe it must; not doing so would arbitrarily eliminate a major and reliable liquidity source for U.S. banks. The Proposals could address this either by permitting banks to include as liquid assets in the numerator of the LCR those assets that may be pledged under existing lines of credit with an FHLB, applying the same haircut that the FHLB applies to the collateral, or recognizing undrawn and available amounts under FHLB facilities as cash inflows in Paragraph 77.

B. Net Stable Funding Ratio

1. NSFR Objective – Structural Funding Changes – Paragraph 78. We urge the Committee to reconsider the fundamental premise behind the NSFR. Paragraph 78 describes the objective of the NSFR as being to "incent **[**structural**]** changes in the liquidity risk profiles of institutions away from short-term funding mismatches and toward more stable, longer-term funding of assets and business activities." Although we support the general goal of addressing excessive reliance on wholesale funding through regulatory oversight, we are skeptical that the best way to do that is with a highly prescriptive ratio applied in the same manner across institutions and jurisdictions over a single time horizon. For centuries, maturity transformation – that is, intermediating the imbalances between short-term and long-term needs of borrowers and the availability of credit – has been an essential economic and even societal function of banks. In setting their risk appetites, banks must balance an appropriate level of prudence against the desired level of maturity transformation.

The NSFR, if implemented as proposed, would create enormous market dislocations. One panelist, in comments at an April 7, 2010 forum hosted by the Federal Reserve Board to discuss the Proposals and the Capital Proposals, estimated that, in order to come into compliance with the NSFR, the 25 largest U.S. banks would need to raise between $1.2 trillion and $1.9 trillion of additional long-term debt, and the largest 20 European banks would need to raise approximately €1.3 trillion of long-term debt. Another panelist at the same forum commented that Swiss banks would need to increase

their holdings of sovereign debt by an amount that is greater than the current outstanding debt of Switzerland. We are concerned that the macroeconomic consequences of narrowing the role of banks in maturity transformation are not understood. Maturity transformation still needs to occur, whether facilitated by banks or by unregulated financial entities.

We are committed to working with the Committee and our national regulators to develop an appropriate approach to structural funding mismatches. Even if the basic approach of defining a ratio of the available amount of stable funding to the required amount of stable funding were ultimately determined to be the right approach, calibrating the ratio at 100% is the wrong calibration. We believe that this area requires substantially more thought and analysis to get to a sound result.

2. <u>Severity of NSFR Scenario – Paragraph 83</u>. The scenario underlying the NSFR is defined in Paragraph 83 in much more general terms than the scenario underlying the LCR, as defined in Paragraph 22. However, the funding parameters for purposes of those ratios seem to be equally conservative. We believe that the need for a more nuanced and flexible approach is even more important for the NSFR, as a longer-term measure, than for the LCR, as a measure designed to assure survival over a short-term period. Experience during the recent financial crisis shows that, notwithstanding its relatively long term, banks were able to take a number of actions to react to the crisis, discussed further below.

We believe that the Committee must lessen the severity of the assumptions used to determine the NSFR. In particular, even assuming a severe economic downturn, the complete unavailability of alternative funding sources seems unrealistic and inconsistent with past events. Indeed, even during the recent global financial crisis, banks were able to conduct asset sales, securitize, raise capital and take other similar measures to bolster liquidity. As currently drafted, the Proposals make no allowance for such alternative funding activities in deriving a bank's available stable funding (and thus its NSFR). We strongly believe that the NSFR should include a factor that could be applied to potential alternative funding measures a bank could take under the applicable stress conditions. The calibration of this factor could be undertaken in consultation with a bank's supervisor and take into account, among other factors, the quality of the bank's liquidity management over the past several years and the ability of comparable banks to undertake such alternative funding activities under stressed conditions of an extended duration.

In general, we believe that the Committee should avoid choosing funding parameters that embody the most pessimistic and conservative, virtually "end of the world," assumptions possible, but rather choose funding parameters with a view toward promoting sound liquidity risk management and measurement policies and practices over an extended period of stress for banks that are assumed to be reasonably well managed. Data gathered from the QIS should facilitate the identification of reasonable funding parameters based on experience from 2007 to 2009. Toward that end, we believe that the NSFR should account for potential alternative funding measures as outlined above.

3. Required Stable Funding Factors for Certain Loans of Maturity Less than One Year. Irrespective of the degree of prescriptiveness ultimately embodied in the NSFR, we believe that the NSFR generally should exclude from the required amount of stable funding short-term assets with no refinancing risk. More specifically, we believe that NSFR should exclude products that do not have the sort of structural mismatch of assets and liabilities that the NSFR was designed to address.

Consistent with the foregoing proposal, we believe that the Committee should treat all matched funded, non-renewable loans with a maturity of one year or less the same as loans to financial companies with a similar maturity. Specifically, such loans should receive an RSF factor of 0% and be excluded from the calculation of the NSFR. Matched funded, non-renewable loans with maturities of one year or less pose neither a refinancing risk nor a structural funding mismatch risk. Moreover, requiring banks to obtain longer-term financing to fund such loans would generally increase the cost of funding such loans, which, other things being equal, will reduce the margin associated with such loans and banks' incentive to make them.

4. Availability of Central Bank Lending Facilities – Paragraph 84. Paragraph 84 specifies that extended borrowing from central bank lending facilities outside regular open market considerations are not considered in the NSFR in order to avoid reliance on the central banks' source of funding. We agree that banks should not plan to rely on lender-of-last resort facilities from central banks. However, it is implausible to expect no central bank support during a financial crisis lasting as long as one year. We strongly believe that the likelihood of central bank support in an extended period of crisis be taken into account.

5. Funding Parameters – Paragraphs 86-89. We urge the Committee to make public the underlying research and data used in developing the ASF Factors in Table 1 and the RSF Factors in Table 2. Many of these factors seem to us to be inconsistent with historical experience, including during the recent financial crisis, and unduly conservative.

6. Treatment of Intangible Assets – Paragraph 89. Pursuant to Table 2 in Paragraph 89, intangible assets fall under the "all other assets" category and therefore require a 100% RSF factor. We believe that this treatment is inappropriate. The Proposals would assign a 100% RSF Factor to all intangible assets, even those, such as goodwill, that do not impact a bank's liquidity. Instead, we believe they should assign an RSF Factor of 0% to intangible assets, such as goodwill, that do not affect liquidity.

7. Federal Home Loan Bank Borrowings. As discussed in Part II.A.8, FHLB borrowings are a major and reliable liquidity source for U.S. banks. We believe they must be taken into account in the NSFR as well as the LCR. The NSFR would give banks no credit for outstanding FHLB borrowings or the bank's ability to drawdown under its facility with an FHLB. It would apply a 0% ASF Factor to outstanding borrowings and a 100% RSF Factor to mortgages and many other types of assets that could be used to collateralize draw-downs on FHLB facilities. We urge the

Committee to permit the U.S. bank regulatory agencies discretion to establish an appropriate ASF Factor for outstanding FHLB borrowings and RSF Factors for collateral that may be used to support draw-downs on FHLB facilities.

8. Maturing Terms Securitizations and ABCP. The Proposals would apply a 0% ASF Factor to term securitizations and ABCP and a 100% RSF Factor to many of the assets underlying those term securitizations or ABCP programs. We strongly believe that, over a longer-term time horizon, securitizations and ABCP programs have shown themselves to be a durable source of funding. We urge the Committee to permit national regulators discretion to establish appropriate ASF Factors for term securitizations and ABCP, and appropriate RSF Factors for the assets underlying those securities.

9. Asymmetric Treatment of Repos and Reverse Repos. The NSFR treats repos and reverse repos inconsistently and, from the perspective of the banking system as a whole, asymmetrically. Paragraph 86 assigns a 0% ASF Factor to repos (where a bank is the borrower) and Paragraph 89 100% RSF Factor to reverse repos (where the bank is a lender). The repo/reverse repo market is primarily a short-term funding market among banks. We do not believe it is logical or appropriate to exclude repos entirely as a source of stable funding in the numerator of the NCR but in the denominator require that 100% stable funding be provided for reverse repos. Repos and reverse repos should either be excluded from the numerator and denominator or included in both with the same ASF Factor and RSF Factor.

10. Asymmetry Between NSFR and LCR. The NSFR includes in the denominator of the ratio – that is, within the required amount of stable funding – a variety of assets that are defined as liquid assets for purposes of the LCR. These include, for example, marketable securities representing claims on or guaranteed by sovereigns having a maturity of one year or more and, depending upon the configuration of the final rules and the establishment of relevant haircuts, corporate bonds. It is illogical to treat an asset as both a liquid asset for short-term liquidity crisis management and a longer-term asset that requires stable funding. Accordingly, we urge the Committee to provide, as a general rule, that assets treated as liquid assets for purposes of the LCR (after giving effect to relevant haircuts) be assigned a 0% RSF Factor for purposes of the NSFR.

C. Monitoring Tools – Section III

1. Reporting Frequency – Paragraph 132. We believe that the reporting frequency of the new metrics – regarding contractual maturity mismatch (Section III.1), concentration of funding (Section III.2), available unencumbered assets (Section III.3) and market-related monitoring tools (Section III.4) needs to be reconsidered in light of the additional data that banks will be required to gather to report the new metrics. At least in the short term, pending development by banks of systems to routinely capture the necessary data, the reporting frequency contemplated will be excessive. Not only do the metrics require banks to gather detailed and potentially difficult-to-acquire information about significant counterparties (Paragraphs 106 and 107)

and extensive information about contractual cash and security flows along multiple time bands, but they also require banks to calculate these metrics on at least a monthly basis, and possibly even weekly or daily basis under stressed conditions at the discretion of supervisors (Paragraph 132). Marshaling the technological resources and staff necessary to collect and report these data with such frequency will prove extremely time consuming and expensive. We urge the Commission to consider a less frequent reporting interval or to provide supervisors with the discretion to extend reporting intervals for certain of the metrics.

2. Significant Counterparties – Paragraphs 106 and 107. Paragraph 107 defines a "significant counterparty" as a single counterparty or group of connected or affiliated counterparties accounting for more than 1% of the bank's total liabilities. We believe the 1% threshold is far too low. Paragraph 104 defines the objective of this provision to be to "identify those sources of wholesale funding which are of such significance that withdrawal of this funding could trigger liquidity problems." That standard should be evaluated in the context of other liquidity tools available to and applied by banks, including the LCR and NSFR. We believe that 5% would be a more appropriate threshold.

D. Operational Challenges

We urge the Committee in developing the implementation schedule for the definitive Proposals to be cognizant of the operational challenges banks will face in implementing the systems and processes necessary to source the necessary data and manage liquidity based on the new liquidity standards. These challenges include, among others, the following:

- Developing and implementing processes to aggregate disparate data relating to the funding factors used in the LCR and NSFR as well as the new metrics concerning contractual maturity mismatch, concentration of funding, available unencumbered assets and market-related monitoring tools. As the QIS exercise demonstrates, in many cases these data are not readily captured or stored in a centralized or integrated manner.

- Banks will need time to educate officers and employees regarding the new informational requirements and to adopt new liquidity management systems and processes.

- In light of the frequency of the reporting requirements of the new metrics (i.e., at least monthly according to Paragraph 132), many banks will need to hire, train and educate additional compliance staff to administrate the systems necessary to comply with such requirements.

- The systems and processes required to manage liquidity risks based on the LCR and NSFR will need to be developed, implemented and monitored.

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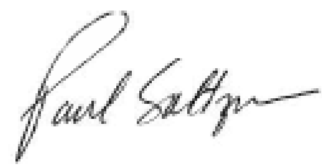
The Clearing House appreciates your consideration of the views expressed in this letter. If you have any questions or if the members of The Clearing House can assist you in any way, please contact Joseph R. Alexander, Senior Vice President and Senior Counsel of The Clearing House, at (212) 612-9234 or joe.alexander@theclearinghouse.org.

Very truly yours,



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