Realkreditrådet
ASSOCIATION OF
DANISH MORTGAGE BANKS

FINANSRÅDET

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To: The Secretariat of the
Basel Committee on Banking Supervision

Response to the revised Basel III Net Stable Funding Ratio

The Association of Danish Mortgage Banks (Realkreditrådet) appreciates the opportunity to comment on the revisions to the Basel III Net Stable Funding Ratio framework. In general, we support the overall aim of giving banks incentives to have long term stable funding instruments to fund illiquid lending or other assets. However, we do not believe that the proposal contains all necessary details for defining available stable funding and required stable funding.

Granularity of time to maturity in ASF/RSF factors.

We support the increased granularity of the Available Stable Funding (ASF) factors taking into account several intervals of time to maturity. This is better than a simple distinction between +/-1 year time to maturity, i.e. it better reflects a sustainable approach consistent with the role of banking industry in the liquidity maturity transformation. For instance, wholesale funding (secured or unsecured) maturing between 6-12 months are now considered 50% ASF. For some asset classes a further granularity of ASF with respect to time intervals would be justified. For example, such further granularity is warranted in case assets are being continuously refinanced. Therefore we recommend a further disaggregation into quarters of a year rather than half a year, to better replicate the risk/reward characteristics, wrt. time-to-maturity, present in the actual marketplaces. Further granularity in ASF would also reduce potential negative effects due to severe ASF “cliff effects” on funding instruments entering the 0-1 year maturity segment as time passes.

Unfortunately, we do not see the changes in granularity wrt. time to maturity for ASF mirrored in the Required Stable Funding (RSF) factors. On the contrary, the granularity of time to maturity of some of the RSF factors has been reduced. Now all unencumbered securities are assigned an RSF factor without taking into account the time to maturity. For instance all level 1 government bonds now are being assigned a 5 percent RSF until maturity. This is illogical and inconsistent with the LCR, which does not impose any limitations on government bonds.

We therefore recommend, that all securities with a maturity less than 12 months are assigned a 0 percent RSF.

Funding instruments with conditional options of extendable maturity

It is not clear how funding instruments with issuer options to extend maturity are treated as stable funding. Instruments with embedded conditional options so that the effective maturity of the instrument is longer than 1 year in case the issuer is unable to refinance the instru-

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ment should essentially be considered long term stable funding. Such instruments include bonds with soft bullets and bonds with a regulatory trigger for maturity extension in case the issuer is unable to refinance.

From the investor's perspective, however, positions in instruments with a conditional maturity extension option should not give rise to a higher level of required stable funding other than what reflects the probability of maturity extension.

In addition, national discretion should be applicable i.e. in the case of regulatory imposed options i.e. to extend maturity cf. paragraph 9[1].

Secured wholesale funding

The NSFR in its current wording does not distinguish between secured and unsecured wholesale funding as all short term capital market funding is treated as unstable funding. As became apparent during the financial crisis, however, the stability of secured wholesale funding instruments including covered bonds proved to be more stable funding than unsecured wholesale funding. In addition, covered bonds can not be drawn by the investors on a daily basis. Accordingly, covered bonds secured by high quality assets and meeting jurisdiction-specific regulatory requirements should be treated as stable funding in accordance with their higher refinancing probability compared to unsecured funding. Thus, ASF factors of covered bonds seems very low i.e. compared to ASF factors on stable and less stable deposits and/or term deposits with residual maturities of less than one year provided by retail and SME customers (respectively 95 percent and 90 percent ASF).

Therefore, ASF factors for covered bonds must be adjusted upwards to better reflect the true funding behavior of covered bonds.

Assets securing covered bonds

According to footnote 9 in the Basel consultative paper "*Encumbered assets include but are not limited to assets backing securities or covered bonds. Unencumbered means free of legal, regulatory, contractual or other restrictions on the ability of the bank to liquidate, sell, transfer or assign the asset."*

When defining the concept of encumbrance it is essential to distinguish between a solvency perspective and a liquidity perspective. The BCBS definition correctly takes the liquidity perspective but draws a wrong conclusion by defining assets in covered bond cover pools as encumbered. All assets in covered bond cover pools adhere to the unencumbrance liquidity criteria as they are able to generate liquidity to pay covered bond holders. There-

[1] *9. The NSFR consists primarily of internationally agreed upon definitions and calibrations. Some elements, however, remain subject to national discretion to reflect jurisdiction-specific conditions. In these cases, national discretion should be explicit and clearly outlined in the regulations of each jurisdiction*, Basel III revised NSFR Framework, January 2014.

fore, assets in covered bond cover pools should be able to be treated as unencumbered just as if the assets were funded by deposits or other instruments. Accordingly, RSF factors on identical assets on the balance sheet should not depend on how the assets are funded.

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Thank you for soliciting our comments as part of your Consultation. We remain at your disposal for any questions or requests for additional information regarding any of the comments set out in our response.

Best regards

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